The Economist

JANUARY 25TH–31ST 2003 www.economist.com

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Politics this week

Jan 23rd 2003
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Ever closer

As the world waited for next week's report of the UN inspectors on **Iraqi weapons**, Britain began sending a large force to join the huge American military build-up in the Gulf region. President George Bush reiterated that time was running out for Saddam Hussein. Colin Powell, the secretary of state, said that if America occupied Iraq its oil would be held “for the benefit of the Iraqi people”.

See article: Divided over war

Around the world, and in several American cities, tens of thousands of protesters **marched against war** with Iraq. In America, the largest demonstrations were in Washington, DC, and San Francisco.

AP

See article: Public opinion and the war on Iraq

France's president, Jacques Chirac, and **Germany's** chancellor, Gerhard Schröder, said they would “harmonise their positions” on Iraq, though it remained unclear how either might vote if there were a new UN Security Council resolution. But France sounded more reluctant than before to vote for war, while Mr Schröder seemed to harden his stand against a conflict.

The foreign ministers of **Turkey**, Egypt, Iran, Jordan, Saudi Arabia and Syria met in Istanbul, to seek a peaceful way out by urging Iraq to comply with the UN's demands.

See article: Iraq, the UN and America

Franco-German entente

The entire membership of the French Assembly and Germany's lower house of parliament, the Bundestag, gathered in the palace of **Versailles** to reaffirm friendship between their two countries, 40 years after the signature of the Elysée treaty. Jacques Chirac and Gerhard Schröder announced a string of initiatives to bring their countries closer together, including their citizens' ability to take dual nationality.

See article: Franco-German relations

Dutch voters went to their second general election in nine months, giving the Christian Democrats a narrow victory, and scything down the party of Pim Fortuyn, the anti-immigration campaigner murdered on the eve of the previous election.

See article: A tight Dutch election

José Maria Aznar, Spain's conservative prime minister, showed his determination to address the **Basque** problem by presenting his name as a candidate in the Basque region's local elections in May.

Britain's Labour government presented a long-delayed review of **higher education**. From 2006, students will face tuition fees of up to £3,000 ($4,900) a year, to be repaid after graduation. Universities which the government thinks are not admitting enough poor students will not be allowed to raise their fees.

See article: Proposals to solve universities' cash problems

British police raided a London mosque said to be connected with terrorism. They arrested several North Africans, and said they had found a stun gun, CS gas and various passports and credit cards.

EPA

See article: More police moves against terrorism

Lord Robertson said he would retire as NATO's secretary general at the end of the year after four years in the job.

Business as usual

The Israeli army demolished more than **60 Palestinian shops** and small businesses near Tulkarm. The Israelis claimed it was because they had been built without permits; the Palestinians called it collective punishment.

See article: The tangled history of Israel and the Palestinians

An American civilian contractor was killed, and another wounded, in an ambush in **Kuwait**, the Gulf country that is playing host to the force gathering to attack Iraq.

Libya was the bizarre choice to chair the **United Nations Human Rights Commission** this year. The selection of a regime with a dreadful record on human rights followed nomination by the African group under a system of regional rotation. Just three members voted against Libya, including the United States—the EU courageously abstained.

The French-sponsored peace conference on **Côte d'Ivoire** looked like ending without a deal. The main issue—whether President Laurent Gbagbo should step down and new elections be held—was left unresolved. Fighting resumed in the west of the country.

Fighting intensified in **Burundi** as the government's forces and the rebels tried to capture as much land as possible before peace talks are resumed in Pretoria.

Striking on and on

In the eighth week of an opposition-led strike aimed at toppling President Hugo Chávez, **Venezuela's** central bank suspended foreign-exchange trading and said it would introduce exchange controls. Jimmy Carter, a former American president, proposed that both sides in the stand-off agree either on a binding referendum on Mr Chávez's rule in August, or an early election.

See article: Trying to end Venezuela's stand-off

At its first monetary-policy meeting under the government of President Luiz Inácio Lula da Silva, **Brazil's** central bank relaxed its inflation targets, from 4.5% to 8.5% for this year and from 3.75% to 5.5% next year, and raised its benchmark interest rate (to 25.5%). Though some investors welcomed these moves, the *real* slid against the dollar.

Seven protesters and a soldier were killed, and over 50 people hurt, in clashes between the security forces and coca farmers calling for a relaxation of anti-drug policy in **Bolivia**. A previously unknown guerrilla group joined the protests.

See article: A new round in Bolivia's drug fight

Tigers gain strength

President Chandrika Kumaratunga of **Sri Lanka** said that since the Tamil Tigers agreed in September to a truce in the country's civil war they have recruited 10,000 new members, many of them kidnapped

children. Norwegian-brokered peace talks continue.

Australian bushfires reached Canberra, the capital, killing four people and destroying more than 450 homes.

Reuters

See article: Australian fires

India expelled two Pakistani diplomats and two other officials for “incompatible activities”, believed to be spying.

A **South Korean** woman was killed by a United States army lorry near Inchon. The deaths of two teenage girls run down by an American army vehicle last year triggered demonstrations calling for a revision of the rules governing the presence of the 37,000 American troops in the country.

Minority report

The Census Bureau announced that Latinos had overtaken blacks as America's **largest minority** group. They now make up 13% of the population (37m in July 2001); blacks make up 12%.

See article: Can Republicans improve their appeal to minorities?

A new study by Harvard University found that—largely as a result of population shifts—American schools are more **segregated** now than before the introduction of civil-rights laws in the 1960s.

See article: Black and white at school

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Business this week

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Feeding frenzy

Tesco, Britain's biggest retailer, joined the list of prospective bidders for **Safeway**, Britain's fourth-largest supermarket chain. Philip Green, a corporate raider with an eye for struggling retailers, plans to trump the only firm bidder so far, Wm Morrison. Kohlberg Kravis Roberts, an American private-equity company, also joined a queue that includes Wal-Mart and J. Sainsbury.

See article: Why more firms should go private

Derek Higgs unveiled proposals to revitalise **British corporate governance** and so avoid Enron-like scandals. He wants fewer “white males nearing retirement age” on boards and a stronger role for non-executive directors. Suggestions of a senior non-executive as a conduit for grumpy shareholders and regular non-executive meetings without the chairman's presence caused worries of boardroom splits.

See article: Britain's corporate governance

Graham Wallace at last gave investors something to cheer about. The announcement that he would step down as chief executive of **Cable & Wireless** gave a lift to the company's shares. Suggestions of a handsome pay-off tempered the celebrations.

America's Securities and Exchange Commission is expected to sue **KPMG** for alleged accounting fraud at Xerox. This would be only the second time in recent years that the SEC has charged a big accounting firm with fraud.

Losing altitude

An American court gave the go-ahead for **US Airways** to submit to creditors a plan for re-emergence from Chapter 11 bankruptcy. It depends on approval of a $900m federal-loan guarantee and resolving the problem of a $3.1 billion gap in its pension fund.

AMR's fourth-quarter loss of $529m contributed to the biggest ever annual loss in airline history. American Airlines' parent company lost $3.5 billion in 2002. **Northwest Airlines** also reported a quarterly loss of $488m compared with a loss of $216m a year before. **Southwest Airlines**, a low-cost carrier, bucked the trend with a profit of $42m.

Delta, **Northwest** and **Continental** airlines, America's third-, fourth- and fifth-largest, said that they would go ahead with a code-sharing agreement without imposing tough conditions set by America's regulators. The airlines promised to defend the arrangement in court, if necessary.

Glenn Hubbard, chairman of President George Bush's **Council of Economic Advisers** and a keen advocate of the recent plan to remove tax on corporate dividends, was reported to be stepping down within the next few months. He is tipped to be replaced by Gregory Mankiw, a Harvard economist.

Less money in the banks

Citigroup's profits in the fourth quarter fell by 37% compared with a year ago to $2.4 billion. The financial-services conglomerate blamed charges of $1.6 billion to cover bad loans, lawsuits related to Enron and settlement of the research scandal on Wall Street.

See article: Hopes and fears of Wall Street

J.P. Morgan Chase suffered a fourth-quarter loss of $387m after the American investment bank took a $1.3 billion charge also to cover losses related to Enron and other legal costs. **Merrill Lynch** did better. Cost-cutting helped to propel the bank to a profit of $603m in the quarter.

Credit Suisse announced a loss of SFr1 billion ($682m) in the fourth quarter. The bulk of the deficit was made up of charges relating to lawsuits brought against CSFB, the Swiss firm's investment-banking arm.

The cost to Japan's banks of non-performing loans became clearer. **Mizuho**, the country's largest bank, said that it expected to make the biggest-ever loss by a Japanese company—¥2 trillion ($16.9 billion)—as the government attempts to get banks to account for bad loans more stringently.

See article: Japan's ailing banks seek new capital

McLawsuit

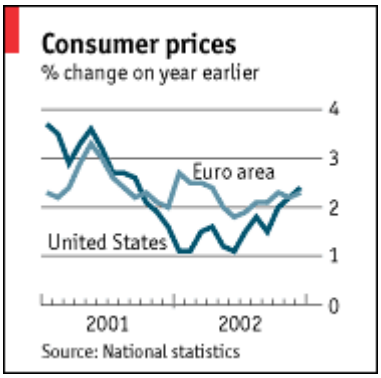
An American judge dismissed a class-action lawsuit brought against **McDonald's** by fat teenagers who claimed that the fast-food chain was responsible for their obesity. The judge decided that it was unlikely that consumers would be unaware of the risk posed by eating a “surfeit” of the firm's burgers and fries.

Opening accounts

After some ten years of attempts, EU governments unexpectedly reached a deal on **savings tax**. Twelve member states will exchange information to stop non-resident citizens evading taxes. Luxembourg, Austria and Belgium will retain banking secrecy but levy a withholding tax and will join the system in the unlikely event that Switzerland drops bank secrecy.

See article: EU ministers reach a deal on taxing savings

Inflation in the **euro area** hit 2.3% in December as prices continued to rise steeply in Ireland, Spain and Portugal. The inflation rate has now remained above the European Central Bank's target rate of 2% for five consecutive months.



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Israel and Palestine

Can Sharon make peace?

Jan 23rd 2003
From The Economist print edition

Getty

The Palestine conflict is soluble, given sufficient attention from the United States

AFTER the war, if there's a war, America will still have its hands full in the Middle East. With one it will have to rebuild Iraq. The other will—or at least should—be devoted to ending the conflict between Israel and the Palestinians. But in their general election next week, Israelis seem poised to re-elect Ariel Sharon, a prime minister demonised in the Arab world and beyond as an implacable enemy of Palestinian nationhood. In such circumstances, can peace be possible?

It would be foolish to wax hopeful after half-a-century of failed peacemaking (see article). In some respects, the conflict in Palestine is more wretched than it has been at any time since the late 1940s. The present fighting is less intense than in the wars of 1956, 1967, 1973 and 1982. But those were mercifully brief clashes between states and armies. Israel's war against the *intifada*, by contrast, is degenerating into an inter-communal struggle of the sort that embitters every heart, places every civilian on the front line and can never deliver a decisive victory to either side. Israelis fear each day that their local bus might be struck by a suicide bomber. Millions of Palestinians are penned up, jobless, under curfew. Both sides are immobilised by fear, hate and a stubborn refusal to yield.

If there's a will

Given this, George Bush can be forgiven for having decided when he took office at the start of 2001 not to copy Bill Clinton, whose Camp David summit had failed, and by failing provoked new violence. To the incoming Bushites, the conflict looked insoluble. If Labour's daring Ehud Barak could not come up with a land-for-peace offer generous enough for Yasser Arafat to accept, what hope of the Likud's Mr Sharon offering more? With this bleak analysis came a reassuring afterthought: even if insoluble, this conflict no longer mattered much beyond the unhappy confines of Palestine itself. It was far from being the world's bloodiest; nor did it look capable, as it had during the cold war, of spreading into the wider world.

Two years on, at least half of this argument no longer applies. The conflict may or may not be insoluble—read on. But there can be no doubt that it matters again. This is not chiefly because of what might happen during an American-led war on Saddam Hussein, even though such a war could indeed suck in Israel, produce new fighting between Israel and Lebanon, or tempt Mr Sharon to expel Mr Arafat. What matters more is that the untreated wound of Palestine is poisoning the already sickly global relations between Islam and the West.

After al-Qaeda's strikes of September 11th, Mr Sharon warned the western democracies not to appease

the Arabs at Israel's expense, as they had appeased Hitler at Czechoslovakia's expense in the 1930s. His point was that Israel should not be blamed for the emergence of Osama bin Laden, who had his own reasons—principally the presence of American “infidels” in Saudi Arabia—for declaring war on the United States. That much is true. But September 11th opened a rift between Islam and the West in which Palestine is indeed playing a growing part. For both fair reasons and foul (the foul including a disturbing surge of anti-Semitism in the Islamic world), Israel's repression of the Palestinians has rapidly become the one issue that can be relied on to inflame Muslims everywhere, and so damage the credibility of its superpower ally. However misconceived, the charge of “double standards” Muslims lay against the United States is deeply felt. In fighting terrorism, as in confronting Saddam Hussein, America has a strong interest in drawing the sting of this allegation.

There may be a way

What, though, if the Palestine conflict really is insoluble? Wouldn't an American peace initiative then merely add to the store of bitterness by raising false expectations? Fortunately, not all of the facts support the case for despair.

The re-election of Mr Sharon is a case in point. Those who demonise Israel will see his re-election as proof that Israelis do not accept the national claims of the Palestinians and will never withdraw from the territories occupied in 1967. In fact, polls continue to show that a solid majority of Israeli Jews favours a peace based on exchanging land for peace, dismantling many settlements, making room for an independent Palestine in the West Bank and Gaza and sharing Jerusalem.

The old hawk himself claims to subscribe to some of these ideas. During his recent campaign for the party's leadership, Mr Sharon twice told his Likud central committee that he did not rule out the creation of an independent Palestine. This is roughly equivalent to a British Tory arguing for the abolition of prison. And in a recent interview, Mr Sharon acknowledged that there was no purely military solution to terrorism. Naturally, there is room to doubt his sincerity. Before elections, politicians tack towards the centre. And Mr Sharon dares not risk antagonising the Americans by publicly dashing Mr Bush's “vision” of an independent Palestine. The scope of the Palestine Mr Sharon has in mind certainly bears scant resemblance to the state the Palestinians want. All the same, it says much about Israel's mood that a hardliner cruising for re-election feels the need to accept the principle of Palestinian statehood. Most Israelis appear to trust Mr Sharon's war leadership. But most also seem to understand the price they will eventually have to pay for peace. If Mr Bush were to mount a credible peace initiative, Israel's voters would go for it.

To make a peace credible, however, the Americans must be able to deliver the Palestinians too. Is that possible? One reading of what went wrong at Camp David is that the maximum Israeli concession fell short of the minimum Palestinian demand. But at the later Taba negotiations, the two sides came within touching-distance. The problem of Jewish settlements was to be solved by dismantling some and giving the new Palestine blocks of Israeli land to compensate for the rest. The Palestinians came close to agreeing that their refugees' “right of return” could not be exercised by swamping Israel's Jews, but through compensation plus a right to settle in the new state. There was near-agreement on Jerusalem. The historians are already quarrelling, but a case can be made that the reason none of this came about was a loss of nerve—and trust—in the face of violence, not the insolubility of any of the problems.

Since Taba, things have grown much worse. The trust that was deficient then has been erased altogether by the subsequent bloodletting. There is no chance now of the two sides settling their differences unaided. That will require the pressure and cajolery of outsiders, and above all of the Americans. Having pulled the plug on Mr Arafat, it behoves America to encourage and nurture an alternative leadership. Up to now, for all his “vision” of a free Palestine, Mr Bush has allowed Israel to clamp a violent calm on the territories while America girds for action in Iraq. But after an Iraqi war, if it goes well, Mr Bush will have extra leverage over Palestine. He will have stirred up the resentment of many Arabs, but he will also have removed one of Israel's mortal enemies, and deprived the Palestinian rejectionists of their noisiest supporter. Here is incentive and opportunity alike for America to push again for peace.

Even for the superpower, such an enterprise is not predestined to succeed. Nobody who knows the history can think that. Palestine contains Jews who still want all the land, and Arabs who still hope to wipe Israel from the map. In America itself there are so-called friends of Israel who will accuse Mr Bush of “appeasement” the moment he pushes hard for territorial compromise. They, above all, should be ignored. Of the 10m people who now live between the Jordan and the Mediterranean, some 5.5m are Jews and 4.5m are Arabs. Before the end of the decade, the Arabs will be a majority. Israel cannot hold

these lands and remain the Jewish democracy it wants to be. Even the Israelis who will vote next week for Mr Sharon know that. It is time their friends in America admitted it too.

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Threatening Iraq

A psychological war, on many fronts

Jan 23rd 2003
From The Economist print edition

Getty

It may be going well in Iraq, but it is proceeding less well in the West

Get article background

IF WORDS were bullets, the ammunition dumps of America, Iraq, Britain, France, Germany, Russia and many others would by now be running low, such has been the verbal crossfire in the past week. That is not surprising, given that on January 27th Hans Blix, head of the team of United Nations weapons inspectors that are hurtling around Iraq, is due to deliver his first formal report to the UN Security Council, and given that signs of Iraqi non-compliance have been seeping out, though not yet any hard evidence of hidden weapons. With America and Britain announcing new military deployments almost daily, tension over what looks like a remorseless march to war is also not surprising. That march, and many of the words, are also tactical, however: they are designed to put pressure on Saddam Hussein in the hope either that his nerve will break or that others—Iraqis, or neighbours—will decide that he must be got rid of in order to avert war.

That psychological pressure looks well orchestrated and is being well executed, though it would gain even greater strength if American intelligence could lead the inspectors to more damning evidence. Such knowledge may be being held back to be disclosed at a time when war could plausibly be launched at a moment's notice and thus when Saddam would have no room to wriggle. Or it may be disclosed at a time when the Security Council is being asked to vote on a second resolution mandating the use of force, thus giving America's wobbly allies little room to wobble. Or it may not exist at all. That is probably the prevailing popular belief in most countries in the West, including even the United States.

For the psychological war on the home front is going much less well than that in Iraq, and is being handled less well. If evidence, or knowledge of how to find evidence, is being held back, then disclosure will in the end help with that war too. Despite the much publicised marches on January 18th in capital cities around the globe, opinion polls frequently show a majority willing to support a war, but only if it is endorsed by the Security Council—which probably means only if evidence is strong enough and plenty of allies support it (see article). Meanwhile, however, the case for a war is being put rather incoherently and confusingly, chiefly because it is being put at different times by different officials, who have different views, and who therefore emphasise different things.

Blood for oil?

That is probably fine for people who, like *The Economist*, have enough faith in George Bush and the democratic disciplines within which he operates to believe that he is unlikely to act recklessly. Many do not share that belief, however. Until facts or events prove otherwise, worry and suspicion prevail. Worry,

because war is inevitably a scary and dreadful thing. Suspicion, because it is often right to be suspicious of governments, especially when they are holding guns and bombs. For that reason, the administration needs to be clearer than Mr Bush has been about exactly why it is following its current policy and, just as important, what it hopes to achieve by it.

On the second of those points, the Bush administration risks inflicting itself with a particularly unnecessary wound. In bars, marches and meetings all around the world, one of the most common accusations is that “it is all about oil”: that oil reserves are what makes Iraq differ from North Korea; and that American oil firms are set to grab hold of them.

The first of those points is partly true. When Mr Hussein invaded Kuwait in 1990 and threatened also to attack Saudi Arabia, he posed a huge threat to world energy supplies. Having oil also gives a dictator of his sort more wherewithal to cause trouble. That was one reason why the first Gulf war rightly took place, and why disarmament has since been the aim.

The second part, though, can readily be dismissed—and should be, in no uncertain terms, by the administration. The oil is Iraq's. An unimperial invader, which America says it would be, would not seize it. Contracts to restore supply (see article) should be handed out by any new Iraqi government as it chooses, not with any coerced preference for American firms. Colin Powell, the secretary of state, was right this week to say such things. His boss should do so, too.

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Corporate governance

Too many chiefs

Jan 23rd 2003
From The Economist print edition

FT

How many people does it take to run a company? Not as many as Derek Higgs thinks

ONE of the oddities of corporate governance is that what looks like a sound structure in one country is anathema in another. Create two boards, German style, with one to supervise and one to manage? Give us unitary boards every time, say the English-speaking nations. Put only non-executives on the board, apart from the chief executive, to maximise the number of supposedly independent voices, as most American companies do? No thanks, say the British, who prefer to see plenty of executives around the mahogany table too. But all three countries have had their share of corporate scandals—suggesting that good governance is driven more by the climate of acceptable behaviour than by board structure.

Yet altering the structure is the only way in which regulators can influence board behaviour. Hence one of the main debates on both sides of the Atlantic has been about the chairman's role. In America, where the separation of the jobs of chairman and chief executive is normally seen as a sign of weakness or as a transitional arrangement, the New York Stock Exchange wants independent directors to meet regularly under a presiding director. Recently, a panel of bigwigs set up by the Conference Board went farther and urged that the two top jobs generally be split. “Everybody needs a boss, especially the CEO,” said Andrew Grove, a member of the panel and the chairman (but not chief executive) of Intel.

In Britain, big companies already normally have a non-executive chairman. This week's thoughtful report (see article) by Derek Higgs, a banker whom the government asked to review the role of non-executives, rightly insists that chief executives should not be promoted to chairmen (which often makes life hell for the incoming boss). But he also wants non-executives to meet regularly without the chairman's presence—and a senior non-executive, identified in the annual report, to be regularly available to shareholders.

Who's in charge?

Effective solutions in boardrooms tend to evolve, rather than to be imposed from without. In companies that combine the jobs of chairman and chief executive, independent non-executives ought to meet regularly without the presence of the boss, and the more assertive the boss, the more essential the meetings. They need, too, a strong “lead director”, to use General Electric's phrase, who will convey their views to the chief executive and perform many of the tasks that a non-executive chairman would do. Once such directors become common, American firms may stop fretting that a separation of the top jobs will breed internecine warfare and hamstring the CEO.

But in Britain, the top job is already split. The chairman's role is often delicate: not to second-guess the chief executive, but to run the board and to be a bridge between the company and its owners, the

shareholders. If chairman and chief executive get along well, the separation is powerfully effective. If they quarrel or snuggle too close, it is either disastrous or pointless. Give too much authority to a third player, a senior director, and that delicate balance may be unstable. Allow non-executives to meet too often without the chairman, and his job becomes unworkable. Better for companies to follow what some already do: appoint a deputy chairman, and see how the role evolves. Let the non-executives, once a year, meet to evaluate the chairman's effectiveness. Too many checks and balances can lead to imbalance and checkmate.

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Copyrights

A radical rethink

Jan 23rd 2003
From The Economist print edition

The best way to foster creativity in the digital age is to overhaul current copyright laws

Reuters

CRITICS have derided a 1998 extension of American copyrights as the "Mickey Mouse Protection Act" because it stopped early images of the Disney company's mascot from entering the public domain. But such laws, they argue, are no joke. Extending and strengthening copyrights, they claim, will help a handful of big corporations crush creativity in the digital age. On the contrary, say Hollywood studios and big record companies. Without stronger copyright protection, a wave of piracy will destroy their industries, depriving consumers everywhere of a broad choice of movies, music and books.

Last week America's Supreme Court weighed into what is rapidly becoming a nasty worldwide battle about the scope and enforcement of copyrights, by rejecting a challenge to the 1998 law on constitutional grounds. But even as it upheld the law, the court expressed misgivings. Blistering dissents from two justices dismissed the 20-year extension of copyright as unwarranted, and even the majority's opinion hinted that Congress's decision may have been "unwise".

The court's ambivalence is understandable. The growing quarrel over copyright is just one of the many difficult issues thrown up by the spread of the internet and related technologies (see our survey of the internet society in this issue). But of all these issues, the copyright battle is becoming one of the most urgent, and bitterly fought, because it could yet determine the future character of cyberspace itself.

Both sides have a point. Digital piracy does indeed threaten to overwhelm so-called "content" industries. As the power and reach of the internet continue to grow, the illicit trading of perfect copies may well devastate the music, movie and publishing industries. The content industries want to protect themselves with anti-copying technology, backed by stronger laws. So far, they have been at loggerheads with technology firms about how to implement such schemes (see article). But a deal between Hollywood and Silicon Valley is likely eventually. Critics are right to fear that, when such a deal is struck, it will be in the interests of big firms, not the public.

A grand new bargain

The alternative is to return to the original purpose of copyright, something no national legislature has yet been willing to do. Copyright was originally the grant of a temporary government-supported monopoly on copying a work, not a property right. Its sole purpose was to encourage the circulation of ideas by giving creators and publishers a short-term incentive to disseminate their work. Over the past 50 years, as a result of heavy lobbying by content industries, copyright has grown to such ludicrous proportions that it now often inhibits rather than promotes the circulation of ideas, leaving thousands of old movies, records and books languishing behind a legal barrier. Starting from scratch today, no rational, disinterested lawmaker would agree to copyrights that extend to 70 years after an author's death, now the norm in the developed world.

Digital technologies are not only making it easier to copy all sorts of works, but also sharply reducing the costs of creating or distributing them, and so also reducing the required incentives. The flood of free content on the internet has shown that most creators do not need incentives that stretch across generations. To reward those who can attract a paying audience, and the firms that support them, much shorter copyrights would be enough. The 14-year term of the original 18th-century British and American

copyright laws, renewable once, might be a good place to start.

However, to provide any incentive at all, more limited copyrights would have to be enforceable, and in the digital age this would mean giving content industries much of the legal backing which they are seeking for copy-protection technologies. Many cyber activists would loathe this idea. But if copyright is to continue to work at all, it is necessary. And in exchange for a vast expansion of the public domain, such a concession would clearly be in the interests of consumers.

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Reforming British universities

The best men won

Jan 23rd 2003
From The Economist print edition

The government is doing the right thing by universities

Get article background

IT ISN'T often that the build-up to a government white paper can honestly be called exciting, but the battle of Britain's universities comes close. It has brought to life the central personal and philosophical divide in the government (see article). It is about something that really matters. And, until shortly before the announcement of the government's new proposals on January 22nd, it wasn't clear which way things would go.

Nobody disputes that Britain's universities are in a mess. The proportion of young people going into higher education has risen from 5% to 35% over 40 years, but universities have not been provided with the money, or the means of raising it, to pay for the increase. The quality of research and teaching have therefore suffered.

But the solution is much disputed. Should the money come largely out of tax revenue—as in Britain and most of the rest of Europe—or from students—as in America? A curious alliance of the left (which believes pretty much everything should be tax-financed) and the rich (who like their children's education being subsidised by poorer taxpayers) wants more tax money. The white paper goes the other way, and proposes charging students more—rightly, since they get most of the benefit.

Should students pay through a tax—which the government would collect from graduates, and use to fund universities—or through loans—which students would repay if they get a reasonably well-paid job? And should the government or the universities set fees? These related questions have formed the main battleground between Gordon Brown, the chancellor of the exchequer, and Tony Blair. Mr Brown wanted fees set by the government to be paid for by a tax collected by the government, which would enable the state to retain control over the universities. That is exactly why Mr Blair and Charles Clarke, the new education secretary, took the opposite view. They wanted to allow the universities the freedom to determine the price, and thus the nature, of the education they offer; and they didn't want the Treasury holding the purse-strings.

Mr Blair and Mr Clarke won, and the proposals announced this week will give universities some freedom from state control. Universities will be able to set their own fees, and thus to differentiate themselves from each other—to offer cheap or expensive, long or short, vocational or academic courses. And without the constraint of Treasury financing, the amount of money going into higher education should rise. British higher education (which gets 1.1% of GDP) should start looking more like America's (which gets 2.3% of GDP).

The cap doesn't fit

Not that the proposed reforms are ideal. For a start, there will be a cap, of £3,000 ($4,800) a year, on the fees that universities are allowed to charge. A good university education can cost much more than that—£10,500 a year, according to Imperial College. Still, caps can always be lifted.

A sillier idea is an “access regulator” to make sure universities take more poor people and fewer rich ones. The problem—that poor children do not get the chances that rich ones do—is a real one, but needs to be addressed earlier. Universities should not be made to pay for the failure of state schools.

But these are minor matters. Mr Blair was bound to make some concessions to Mr Brown to get these proposals through cabinet. It was worth it: they could be the best thing that has happened to British universities for decades.

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Letters

Jan 23rd 2003
From The Economist print edition

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Torture arguments

SIR – In its war against terrorism, America has an unquestioned moral advantage ("Is torture ever justified?", January 11th). All the more important then that methods such as torture are not used. Acquiring information through torture reduces the moral advantage and can only help to garner sympathy for terrorists.

Greg Anglea
San Diego

SIR – I am puzzled by your reluctance to allow for the torture of detainees under special "ticking-bomb" circumstances. You base this on the slippery-slope argument: selected cases may grow into casual practice over time. Does not the case for a pre-emptive strike on Iraq, which you support, suffer from the same weakness? With a pre-emptive war here and there, where will it all end? If the case for a war on Iraq is persuasive on ticking-bomb grounds (as I believe it is), so is the case for allowing torture under very special conditions.

Gabriel Sipos
Kosice, Slovakia

SIR – Well done for chastising America for allowing the torture of suspects in the name of its war on terror. President George Bush and his advisers are clearly mistaken about the essential nature of freedom. Freedom and democracy are not the results of economic success and political strength; it is the other way round. Compromising freedom in the name of security is always doomed to fail.

Mark Russell
Seoul

SIR – I am surprised to read that "Since the arrival of those first inmates at Guantanamo, visits to the base by the International Committee of the Red Cross [ICRC] and by journalists accord with American denials that anyone is being tortured there" ("Ends, means and barbarity", January 11th). This is a sweeping statement that could lead to false conclusions. The ICRC has never said anything publicly that would justify such an opinion or, for that matter, its opposite.

The ICRC has indeed been visiting persons held at Guantanamo Bay for a year now, with the consent of the American authorities, and plans to continue these visits. However, it cannot be concluded that because the ICRC visits Guantanamo Bay it either approves or disapproves of the conditions of internment there. The absence of any public statements corresponds to standard ICRC working practices. Findings and observations concerning the treatment of prisoners are discussed exclusively and confidentially with the authorities holding them. This makes it possible for regular repeat visits, enabling our staff to monitor the situation of detainees over the entire period of their captivity. It also prevents highly sensitive information from being exploited for political gain.

To some the reluctance to pronounce publicly might appear odd in a world that assigns such importance to a presence in the media. However, there can be little doubt that our method bears fruit: last year, our delegates visited over 350,000 detainees in different conflict zones across the world; for many these visits constituted their only contact with the outside world.

Antonella Notari
ICRC
Geneva

Committing to paper

SIR – You neglect one of the major motivations for computerising everything. Paper is an unstable storage medium ("In praise of clutter", December 21st). Paper files can be messed up by a colleague; the contents can be lost; and they are vulnerable to fire and theft. It is the apparent security and solidity of digital files and folders which leave many of us slaves to the computerised-filing system.

Nonetheless, digital storage is less secure than paper in two critical respects. First, decoders for paper are eyes and brains which do not need updating. Second, digital media decays faster than paper. Anyone can read Shakespeare's original texts. If his work had been saved on disk it is unlikely that the original would remain in a readable form.

Chris Grannell
London

Drop the pilot

SIR – Your article on pilotless planes reminds me that, apparently, cockpits of the future will contain a computer, a pilot and a dog ("Help! There's nobody in the cockpit", December 21st). The computer will fly the plane, the pilot will watch the computer and the dog will bite the pilot if he touches the computer.

Gerard Conroy
Reading, Berkshire

Singapore's water

SIR – Contrary to your suggestion, Singapore's long-term water supply is no laughing matter ("Introducing newater", January 11th). It is fundamental to Singapore's survival. Hence, when Singapore became independent from Malaysia in 1965, in the separation agreement, both countries guaranteed the observance of the two water agreements governing the sale of water to Singapore. Far from being driven by "national pride" or by a desire not to "rely on Malaysia for anything", Singapore has always wanted to renew the water agreements. Since December 1998, both countries have been discussing this and other bilateral issues to resolve them in a package deal.

We were close to an agreement in 2001. Malaysia indicated that 60 Malaysian sen (16 cents) per 1,000 gallons, with a five-yearly review, would be a fair price. In the context of the package deal, Singapore accepted Malaysia's price for future water but counter-proposed 45 sen for present water. In March 2002, Malaysia suddenly reversed its position. For present water Malaysia asked 60 sen from 2002 to 2006, and then three ringgit from 2007 to 2011. After 2011, the price was to be reviewed annually for inflation.

In September 2002, Malaysia again revised its proposal. It now asked to benchmark the price of present water to the cost of desalination and newater. Malaysia also did not want to discuss future water until 2059, just two years before the expiry of the second water agreement. Faced with the likelihood of no renewal of supply from Malaysia, Singapore has to prepare to be totally self-sufficient after 2061. With newater and decreasing desalination costs, we are confident that Singapore can be self-sufficient by 2061, should this be necessary.

Michael Eng Cheng Teo
Singapore high commissioner
London

Futile exercise?

SIR – You fail to identify the strong chemical motivations behind exercise ("The new puritans", December 19th). Working out causes the body to release into the blood powerful, morphine-like endorphins. Gym firms, in a sense, sell this natural drug to their highly addicted customers.

Zachary Mazur

Rio de Janeiro

SIR – People exercise for the same reasons that they drink: it makes them feel good but without hangovers, ill health and a depressed mood. If only insight was accompanied by discipline, I would exercise more than I drink.

Tom Ellefsen
Bangkok

SIR – Be careful what you malign. Working out frees time for reading your publication.

John Meakem
McLean, Virginia

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Israel and the Palestinians

It should have been so simple

Jan 23rd 2003
From The Economist print edition

Alamy

The fight over land that could have been peaceably shared has lasted more than half a century and is still the defining issue for the Arab world

ALTHOUGH Ariel Sharon's triumphant bounce back to the prime minister's office has been mildly deflated by tales of financial sleaze, Israeli voters are all set to re-elect him on January 28th. And they will do so largely because of his stand on Palestinian issues, even though most of them support the Palestinian policy of his challenger, Amram Mitzna. Paradoxical? Yes, but par for the course of an interminable Israeli-Palestinian catalogue of muddle, paradox and wasted opportunity.

Mr Mitzna is proposing a hard-edged policy: first a call to the Palestinians for swift negotiations but then, if the Palestinians procrastinate or prevaricate, Israel's unilateral withdrawal from all of Gaza and most of the West Bank, plus the completion of an impassable barrier to keep the no-longer occupied Palestinians out of Israel. Opinion polls show that most Israelis would go along with this: they would like to be out of most of the occupied territory that has caused them woe, and they crave to be safely cut off from neighbours they have come to dislike and fear.

Mr Sharon would fulfil neither wish. Despite paying lip-service to the idea of a Palestinian state, he promotes a settlements policy that absorbs into Israel large chunks of the land that would be essential to such a state, and, in the name of fighting terrorism, is cutting the heart out of any future self-governing authority. Yet, as our correspondent explains (see article), the Israeli electorate trusts Mr Sharon.

The Israeli-Palestinian conflict is not only paradoxical but, apparently, bottomless. Yet its bottom has always been plain to the eye. The dispute's longevity, the intractability—often the vileness—of many of the players on either side, the sheer boredom of the dispute's unchanging nature have encouraged weary observers to declare it insoluble. They are wrong.

For a start, boredom is a luxury that outsiders cannot afford: they ignore the dispute at their peril. The conflict has not only done dreadful things to the two peoples concerned—reducing aspiring Palestinians to penury and sturdy Israelis to paranoia—but its tentacles stretch far and wide, distracting or distorting both public opinion and government policies. The Arabs, and to some extent the wider Muslim world, have chosen to make a defining issue of the Palestinian case.

After September 11th, George Bush said that he expected the outside world to be for or against America's fight on terrorism. American muscle gave his words credence. The Arabs, and other Muslims too, say that they expect the West to support their fight against the injustice the Palestinians have

suffered at the hands of Israel, or else. Or else what? It is a fair question. The Arabs have been clumsy in their handling of the western political scene, and are armed with self-interested reasons for allowing their threat to float emptily.

But it doesn't go away. The Islamist terrorists who now threaten the West and its ways are inclined to find it handy. Osama bin Laden and his kind may not give much of a damn about Palestine, but it is a solid-sounding cause that wins converts where vaguer anti-Americanism does not. On a much broader scale, when the Americans go asking Arab governments for support, the Arabs rap the question back: when are the Americans going to do something about Israel? Quid for quo, they don't quite say, one good turn deserves another.

Barak, Clinton and Arafat: a bright fleeting hope

The point is that the “something” they demand is not impossible. Some international disputes seem beyond the ingenuity of man to solve. But the Israeli-Palestinian dispute is not one of those. Both the quarrel, and its resolution, are blazingly simple: two peoples fighting over a patch of land that would surely be better shared.

And, only a short time ago, both the Israelis and the Palestinians had reached the point of accepting that this was the answer and it could be done. There were people then, as now, vehemently opposed to sharing. But, under Bill Clinton's tutelage, Yasser Arafat and Ehud Barak seemed on the way to a fair split that would have ended the conflict. Tragically, the chance was bungled and, once again, the end recedes to never-never land.

Yet when the Israelis and Palestinians do finally bring themselves, or are brought by others, to come to terms, the answer will almost certainly be first cousin to the hoary old solution suggested more than half a century ago before the very first Arab-Israeli war broke out: a clean division of Britain's former Mandate of Palestine into Israeli and Arab states.

When the British retired from their mandate in 1948, they left the key under the mat for Jews and Arabs to fight over. The United Nations had come to the rescue, devising a legal partition of the territory. The Arabs refused to accept this, though it gave the Israelis a far more modest state than the one they then had to fight for and win. At this time, and for many years thereafter, it was the Arabs who kept the conflict going—though then, as now, they were helped by Israel's ever-readiness to keep the fire stoked.

The cuckoo in the nest

For a long time, the Arabs stubbornly held out against recognition, refusing to accept the existence of a Jewish state in their midst. They stood by their belief that the establishment of Israel on Arab land, at the expense of the Arabs who used to live there, was a temporary setback that was bound eventually to be put right by pan-Arab nationalist endeavour. They were outraged that the Arab world should have been made to suffer unjustly for Europe's crimes against the Jews. They spoke of Israel as a cuckoo in the nest, forgetting that it is the cuckoo that thrives, chucking the resident nestlings out.

But by the mid-1970s, after repeated military defeats—in 1948, 1956, 1967 and 1973—most of the Arab world had come reluctantly to accept, in their minds if not their hearts, that Israel was there to stay, a permanent Jewish fixture in an Arab region. In 1978, Egypt, which not only had the largest army but had also been, until then, the leading Arab nationalist voice, brought itself, under Anwar Sadat, to face reality, and made peace with Israel. All realistic prospect of a pan-Arab military drive against Israel died at that time.

By then, too, the central issue for most Arabs had changed or was changing. For most, including the top Palestinian leaders, the ambition was no longer to get rid of Israel, but to get it out of the Arab territory—in Egypt and Syria, as well as the whole of the West Bank and Gaza—that it had occupied in 1967. Egypt, offering a formal peace treaty, got its own land back. The others did not. The Sinai desert and slivers of Jordan apart, Israel still sits on all the land it seized 35 years ago, transforming much of it with the permanent settlement that international law prohibits on occupied land.

The central problem of occupied Palestine remains an open, bleeding sore. In 1987, the Palestinians living under occupation rose in revolt against their circumstances. They were slowly crushed by their

Israeli occupiers, and television showed them being crushed. With public opinion aroused, and with America and its allies successful in the 1991 Gulf war, the Israeli-Palestinian dispute worked its way to the forefront of international policy.

The Americans led a movement, starting with a Madrid conference, in quest of peace. While this movement was lumbering along, a secret Israeli-Palestinian peace process, nurtured by the Norwegians, magicked the 1993 Oslo accords which pointed a quicker, phased route towards a settlement. It was, with detail and variations, the same formula as ever—the division of the land in return for peace—but it seemed to offer a better chance than ever before that the conflict might end.

After seven years of spiralling down snakes and clambering back up ladders, a final agreement seemed within touch. This would have split the land of the old mandate, giving the Palestinians most of the West Bank and Gaza (which together account for only 22% of the old mandate). The remaining differences between the two sides were tricky but not insuperable, given goodwill and time.

But elections were looming, and the Americans and Israelis were in a hurry. Mr Barak was prepared to concede more than any Israeli leader before him, but held back from making his offer firm. Mr Arafat, instead of showing bold leadership, listened to public opinion at home and dithered. Both teams, in the end, were ham-handed, dropping a uniquely precious ball, and the region was plunged into a bleakness that still prevails.

A second, but this time wholly misbegotten, Palestinian uprising then broke out. The first outbreaks rose from spontaneous frustration, but the revolt gathered speed without ever acquiring an aim. Senseless killing inflamed senseless killing; the current *intifada* has turned out to be quite extraordinarily self-destructive.

Politically, it shattered Israeli trust, destroying, in the blink of an eye, the gains painfully gathered.The popular Israeli refrain—“We gave the Palestinians land and they replied with bullets”—is a crude simplification, but it is how the Israelis feel. Militarily, the *intifada* gave Mr Sharon, by then Mr Barak's successor, a pretext for crushing the life out of all the central Palestinian institutions and locking the Palestinian people into what amount to detention camps in their towns and villages. And as Palestinian suicide bombers ply their dreadful trade, the Palestinian cause falters in the western world.

Love-hate relationship

Yet, in the Arab world, support for the Palestinians is unfaltering. Why? It is a question worth asking, since it is by no means self-evident why other Arabs, with their own interests and problems, should care so much about the Palestinians and theirs.

In an Arab world of nearly 300m people, the 9m Palestinians (half of them resident in the West Bank, Gaza or Israel, and the other half living in the diaspora, mostly in Arab countries) have an altogether disproportionate influence. As the Americans scour the Arab world, looking for allies in their campaign against Iraq, they are told repeatedly that support might be there for the asking if the United States, instead of fussing exclusively about Saddam Hussein's defiance of UN resolutions, was concerned about Israel's 35-year disregard of the UN's instruction to get out of territory seized in war.

Let America, the Arabs demand, exert pressure on its partner. It has become axiomatic that Arab compliance on Iraq, and American action on the Israeli-Palestinian conflict, go together like horse and carriage, if not love and marriage.

Love, as it happens, has nothing to do with it. Nobody could say that other Arabs like, or have been kind to, the Palestinians whose cause they champion. With Jordan and Syria honourable exceptions, the Arab world was reluctant to accept them as refugees when tens of thousands were forced to flee in 1948-49. The Arabs' excuse for their inhospitality was that they did not want to give credence to the Palestinian flight as a permanent exodus. Over time this excuse has grown increasingly feeble.

Look at Lebanon, where the Palestinians are still condemned to squalid refugee camps, denied work and normal social services, dependent on UN charity. The Palestinian refugees have been kept stateless, partly to help their political cause survive, but also because Arab governments see them as potential troublemakers and do not want them as citizens. And sometimes not even as visitors: when Mr Arafat made one of his grosser mistakes, siding with Saddam Hussein after Iraq's 1990 invasion of Kuwait, the Gulf states expelled their Palestinian workers *en masse*.

The Palestine Liberation Organisation (PLO) has been pushed bloodily from pillar to post, more by the Arabs than by Israel. Most Arab governments find Mr Arafat a terrible nuisance, and his injured people a trial. They would love them just to go away. Their cause—the loss of Palestine to Israel—is a constant reminder of Arab defeat and humiliation by a small, alien country. It is a dreadful memory that will fade only if the Palestinians have a state, however small, of their own. As long as they have not, the Arab world's clear failure to put a bad situation right provides fuel for the militant opposition in almost every Arab semi-dictatorship.

While the West Bank and Gaza remain in Israeli hands, the Palestinian cause is a rich source of Arab dissidence. It is used by radical nationalists and by militant Islamists alike to raise unanswerable questions against their own regimes, a banner under which to wave their dissent. What sort of feeble government do we have, they demand, that cannot even liberate a bit of Palestine? However unfair or irrelevant the question, it highlights the rottenness that is believed by many radicals to lie at the heart of Arab regimes.

Getting rid of the old men

From this bleak point, how can outsiders start clawing a way back to a situation in which peace would again seem hopeful? It has become evident, at this stage anyhow, that the Israelis and Palestinians cannot manage this on their own.

The general theory is that the Europeans, who provide the Palestinian Authority with a fair dollop of its money, should deliver the Palestinians to the negotiating table, while the Americans, who are the only outsiders that the Israelis give a toss for, should deliver Israel. This has not worked so far.

Mainstream Palestinian leaders desperately want to get back to the table, pinning their hopes to the belief that renewed negotiations, with managers and monitors from outside, are their one chance of getting back on course towards a viable Palestinian state. But the Israeli government, supported by the United States, insists that there can be no talks until Palestinian violence comes to a stop. And Mr Arafat and his men simply cannot bring this about. Their authority has been dissipated, partly by their own failure to lead decisively, and even more by the ferocity of the punishment that Israel has meted out to them and their people.

Factional Palestinian rulers are now in charge. There is a continuing attempt, under Egypt's aegis, to bring these leaders to accept a “ceasefire”. This would be partly an agreement to limit the violence by barring all killing of civilians in Israel. Even more important, perhaps, it would commit the stand-out diehards to limiting their aims to a state in the West Bank and Gaza, and it would establish that the refugees' right of return would be “by agreement between the two parties”. If the militant Islamist movement, Hamas, were to agree to those last two points, it would mark considerable progress—but it is the Arabs' tragedy that they agree to things too late, when the Israelis have long moved on. Moreover, so long as Mr Sharon's men continue their policy of siege, repression and targeted assassinations, the factions will not abandon their “right” to armed resistance.

The Americans are equally unsuccessful with the Israelis, but for a very different reason. Mr Sharon is in charge all right, but, having put his faith in a slugging military solution, he does not want to be compelled to the negotiating table until he can lay down terms that suit his concept of what a Palestinian state should be. Unlike some of his far-right allies, Mr Sharon agrees, in theory, that there should be a Palestinian state, but suggests an emasculated pretence of one, set up in disconnected parcels of land.

The Bush administration, at least so far, has been clearly reluctant to lean on the Israelis to do what they do not want to do (it is a sign of Israel's superb grasp of western power-politics that though it can sometimes be coaxed towards certain actions, it, unlike the Palestinians, can almost never be forced). The Americans may, however, have prevented the Israeli government from doing certain things, such as deporting Mr Arafat, which it probably would have done otherwise. Though Mr Bush has publicly accepted Mr Sharon's thesis that Mr Arafat is no longer a partner for peace, his immediate need to keep the area as quiet as possible takes priority.

While clearly out of sympathy with the Palestinian leaders, Mr Bush was praised for a speech he made last June, looking to an Israel and a Palestine living peaceably side by side. More important, his administration is playing a leading part in an attempt by the so-called quartet—America, the EU, the UN and Russia—to map a way from here to there.

But a map is not much good unless the Israelis and Palestinians can be prevailed upon to follow it. And this, gloomsters say, will not happen so long as the two old men, Mr Sharon and Mr Arafat, remain where they are. Mr Sharon is a disaster because he does not accept the central land-for-peace equation; Mr Arafat because he has lost control and drifts with the tide of events. But both are democratically chosen. Mr Sharon is about to be re-elected; Mr Arafat would have been if the Palestinians had been able to hold the election planned for this month. Mr Sharon, it is generally believed, is merely waiting for an opportune moment to send Mr Arafat packing. It is much harder to see, with the Israeli public in their present frame of mind, who can send Mr Sharon packing.

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Americans and Iraq

We, the ambivalent people

Jan 23rd 2003 | WASHINGTON, DC
From The Economist print edition

EPA

Public opinion will have little impact on the administration's policy, either for or against war

Get article background

IN FREEZING weather last weekend, 50,000 anti-war demonstrators dusted the lawn in front of the Capitol like light snow. Priests opposed military action on religious grounds. White-haired populists from Iowa and Minnesota spoke against global adventurism. War veterans opposed using force except to defend America from invasion. It seemed mainstream.

Up on the platform, though, all-purpose radicalism prevailed. “Free Mumia”, yelled one speaker (referring to an imprisoned cop-killer). Another denounced the Colombian government. An imam called for regime change in the White House.

There is a good deal of unease about a second Gulf war. There is also a lot of support. What matters, it seems, is coherent leadership, which is lacking among opponents. The upshot is that, over Iraq, public opinion puts few constraints on the president's freedom of action.

Americans support war in Iraq by large majorities—around 60% in all current polls. That figure has been stable for six months. The one exception—a finding by the Pew Research Centre—suggests that support rose between October and January (see chart 1). It has not yet been affected by the dip in the president's own popularity or by increasing scepticism about his handling of terrorism and the economy.

For opponents of war in Europe, the headline number suggests there are domestic political reasons for Mr Bush to go to war. But if his administration were ever to think this (and they don't), they would be profoundly mistaken. The truth is that American public opinion is more complex than the headline support would suggest.

For war, but not alone 1

Support for military action in Iraq, %

	Aug 2002	Sep 02	Oct 02	Jan 03*
Favour	64	64	55	68
Without allies	30	33	27	26
With allies	30	25	23	37
Oppose	21	23	34	25

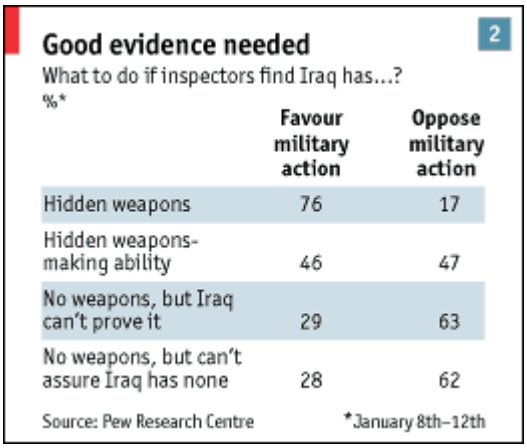
Source: Pew Research Centre *January 8th–12th

In January, 68% told the Pew pollsters that they would support military action in general. Without allied backing, this figure falls to 26%, even lower than last September. The largest single group—37%—would support war “only if allies agree”.

Fewer than one in three say they would support military action if no weapons are found (see chart 2). Even if inspectors find a weapons-making programme but no “smoking gun”—perhaps the

administration's most plausible best case—Americans are still divided: 46% in favour, 47% against. Only if inspectors find weapons of mass destruction would Americans back force, in this case overwhelmingly. Underlining the caution, a new *Washington Post* poll found 43% saying inspectors should have as much time as they want and a further 24% saying they should get a few more months.

On the face of it, this looks worrying for the administration. Pro-war sentiment is soft. If Americans want "allied help" (whatever that means), then divisions in the United Nations Security Council might drive public support down. And if Americans want to give inspectors more time, isn't Mr Bush defying his public (as well as the French) in saying there is no cause for further delay? Not really. The strange combination of unwavering general support and considerable nervousness about details almost certainly means the public will give the president a lot of latitude.



Good evidence needed 2

What to do if inspectors find Iraq has...?
%*

	Favour military action	Oppose military action
Hidden weapons	76	17
Hidden weapons-making ability	46	47
No weapons, but Iraq can't prove it	29	63
No weapons, but can't assure Iraq has none	28	62

Source: Pew Research Centre *January 8th–12th

This is what has happened historically. Peter Feaver of Duke University, co-author of a forthcoming book on public opinion and war, says that since the Korean war 10% of Americans have opposed all military action (that was the share against war in Afghanistan). The administration cannot win them over. One-third support all wars (that was the share that backed the Vietnam war to the end). They will support Mr Bush, more or less regardless. The question is what happens to the others.

Around a quarter are "casualty-phobic". The Pew poll suggests the prospect of mass casualties drives support down sharply. But in response to a question that stresses only the costs of war, not benefits, 43% still back action. The Vietnam war suggests that lack of support is decisive only when it dips below 40%.

So the most important segment is the one Mr Feaver calls "defeat-phobic". So long as the administration can claim that war is justified and that America is winning, it should carry this part of the public, which, combined with the "war party", makes a majority. Indeed, bizarre as it may sound, some of the "defeat-phobes" may now be among the war's opponents. Before the last Gulf war, one poll asked those who disapproved of the then Bush administration's policy why they did so. Amazingly, a plurality said it was because America was moving too slowly.

Those who express reservations about war think Mr Bush has not yet made a case for it. Over half say so, up from 37% in September. But this is reversible (the numbers were much better after Mr Bush's UN speech). Next week's state-of-the-union message will begin another round of explanations, which should gain in persuasiveness as the decision to attack is made.

In the Pew poll, the rise in the number of those who support war if allies agree roughly reflects the drop in the number of opponents. A likely explanation, at a time of massive troop deployments, is that people think war is inevitable and that they want others to bear some of the risk. That does not mean they would oppose war without allies, or with Britain alone, if it were the only option.

Lastly, public opposition is unlikely to be a constraint unless the war's opponents can find national leadership. At the moment, support is partisan: 80% of Republicans back the use of force, compared with 46% of Democrats. But all except one of the Democrats' leading presidential candidates supported the congressional resolution authorising force. What was seen in microcosm at the anti-war demonstration is true nationally. Mr Bush has opposition to war where he wants it.

This gives him a lot of options. If he goes to war, people will support him (indeed, the first effect will be a huge rally round the flag). If he gives inspectors more time, people will back that too. From the point of view of voters, a second UN resolution looks desirable, not essential. The only doubt is what happens in the unlikely event that Mr Bush decides not to go to war. In that case, his conservative base will doubtless accuse him of flinching, like his dad. But for the public, even that course may be tolerable, if the president can convince them that his threats have disarmed Saddam. In short, in terms of the administration's freedom of action, reluctant acceptance of war without appetite looks better than bloodthirsty enthusiasm.

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Medicaid

Chopped out

Jan 23rd 2003 | WASHINGTON, DC
From The Economist print edition

With state budgets in crisis, this is no time to be poor and ill

THESE are hard times in America's state capitals: the worst, some are saying, since the second world war. From California to Connecticut, governors are rolling out their budgets and coming clean on how they plan to plug the yawning gaps between the money that will come in next year and what they need to spend.

In all, America's states faced a budget shortfall of over $50 billion this year. The next fiscal year—which, for most states, starts in July—will be even worse. They need to find an additional $60 billion-85 billion to balance their books. And since all the states, Vermont excepted, are barred by their constitutions from running deficits, the gaps must be filled.

For the past couple of years most states have dealt with the economic slowdown by trimming the obvious fat from their spending, by using rainy-day funds set aside during the booming 1990s and by simply fudging the numbers. No longer. With the fiscal squeeze now heading into its third year, governors have to make tough decisions. Diehard conservatives, such as Dirk Kempthorne of Idaho or Sonny Perdue, the new governor of Georgia, have been obliged to propose tax increases. And virtually all governors are also proposing painfully deep spending cuts. With education spending (the biggest item on any state's budget) both politically popular and often protected by statutes, the knife risks falling on the next biggest—and fastest-growing—state expense: health care for the poorest.

America's poor get their health care through Medicaid, a programme funded jointly by the federal government and the states. Though much less well known than Medicare, the federal health-care scheme for old people, Medicaid actually covers more Americans (44m, as against 40m) and costs more (a total of over $230 billion in 2002, against $215 billion). On average, Medicaid costs now make up around 15% of a state's overall spending.

Like the rest of American health care, the costs of Medicaid have spiralled in recent years as everything from drugs to long-term care has become more expensive. Medicaid's costs are also rising because the programme serves ever more people. Flush with cash in the go-go 1990s, many states widened eligibility for Medicaid and extended the services it would provide. These aims were noble but unaffordable, particularly as the economic slowdown has pushed more people on to Medicaid. In 2002 Medicaid costs for the states, on average, rose by 13.3%, while total state spending grew by only 1.3%.

Virtually all the states have already tried to cut their Medicaid bills. A recent survey by the Kaiser Foundation found that, halfway through their fiscal year, 49 states have cut, or plan to cut, Medicaid expenses. Over 30 have already had two rounds of Medicaid cost-cutting. Almost all the states have tried to trim costs by controlling more tightly the prices they pay for prescription drugs. Over half have frozen or reduced the rates at which doctors are reimbursed for treating Medicaid patients. But with the budget outlook for 2003-04 even grimmer, many health experts fear far bigger cuts are in the offing.

California is a good example. The state faces a fiscal gap of $34.6 billion (a $10 billion shortfall for the rest of this year, and a projected gap of more than $24 billion for next year). That hole is twice as big as the state's entire health-care spending ($13 billion). To help close it, Governor Gray Davis wants to cut the state's spending on Medi-Cal (as California's bit of Medicaid is known) by $1.5 billion, or 5%. Add the lost matching money from the federal government, and that is a cut of nearly 10%.

To make the savings, Mr Davis proposes to reduce the number of people eligible for Medi-Cal, slim down the services it covers (eliminating, for example, dental care and physiotherapy) and cut by 15% the amount it reimburses doctors for them. The eligibility threshold for working families is to fall from 100%

of the poverty level to 61%, or from around $18,000 for a family of four to under $12,000.

The narrowing of eligibility will affect at least 200,000 people. But health experts in California reckon the pain will go deeper than that. Today almost half of all Californian doctors refuse to treat Medi-Cal patients. According to the California HealthCare Foundation, there are only 38 general doctors for every 100,000 people on Medi-Cal—about half the minimum number recommended by the federal government. If reimbursement rates fall, that ratio is likely to get worse.

These proposals, and tough ones in other states, may get changed on their way through state legislatures. But the grim truth is that Medicaid will bear its share of the current budget squeeze. The problem goes beyond the current economic slowdown. Like Medicare, Medicaid faces a future of rising drug prices and the soaring health-care costs of an ageing population. With their tax base eroding, the states will be increasingly unable to cope with these costs. In short, Medicaid needs comprehensive reform. Unfortunately, judging by the history of health-care reform in America, it is unlikely to get it.

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Trouble at Los Alamos

Next stop for Blix?

Jan 23rd 2003 | SAN FRANCISCO
From The Economist print edition

Even America has a hard time keeping track of its arms programmes

IT BUILDS weapons of mass destruction. And it cannot account for dozens of computers and hundreds of thousands of dollars' worth of other equipment. Were the goings-on that have lately been exposed at Los Alamos National Laboratory in New Mexico to be uncovered in Iraq, the United Nations weapons inspectors would pounce on them with a furious cry.

Los Alamos, where the first atomic bombs were built, is in as bad a crisis as it has known since the end of the cold war. This time the concern is not about its fundamental job; indeed, the realisation that the world has not been made safe by the collapse of communism, and that there are still explosive dangers out there, has put a spring back in the step of nuclear-weapons designers. The current trouble is about that familiar old villain, simple mismanagement.

The University of California has run the laboratory for the Department of Energy since it was founded in 1943, but after years of basking in reflected glory it now finds itself on the defensive and looking embarrassed. The Federal Bureau of Investigation, the energy department and several congressional committees are all investigating reports that researchers have been misusing federal money. Some are alleged to have used official credit cards to buy things for themselves—including, in one case, a car. Others are said to have pilfered equipment. The laboratory's auditing system did not log most equipment worth less than $5,000, and many smaller items are unaccounted for.

The university issued a report on January 10th saying that it had got to the bottom of things, only to retract it a week later. At the same time, buckling to pressure from Congress, the laboratory has rehired as advisers two former security officials whom it had fired last summer after they raised a stink about the abuse. The laboratory's director resigned earlier this month; an interim director is promising to shake up the management.

He will have to work fast. Spencer Abraham, the secretary of energy, has hinted that he may curtail the university's contract to manage the laboratory. Lockheed Martin, an aerospace firm, runs Sandia National Laboratory, also in New Mexico, and its operations have been held up as an efficient contrast. The University of Texas is also hovering. It has scientists aplenty—and friends in high places.

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Taking Nunn-Lugar global

A new arms race

Jan 23rd 2003
From The Economist print edition

Keeping dangerous weapons out of dangerous hands

WHEN Senators Sam Nunn and Richard Lugar first managed to wring some cash out of Congress for dismantling “loose nukes” in what is now Russia and its neighbours, sceptics argued that paying America's cold-war enemy to do its own nuclear clean-up was money down the drain. Ten years on, these Nunn-Lugar funds have swelled to more than $1 billion a year. Since the September 11th attacks, President George Bush has made the effort to stop nuclear, chemical and biological weapons and materials falling into the hands of rogue states and terrorist groups one of the central principles of American foreign policy.

Mr Nunn is gratified by all this, but far from satisfied. He wants to make preventing catastrophic terrorism the central principle of the 21st century—for all governments, not just America's. He likens the effort to a perilous new arms race. “Terrorists are racing to acquire nuclear, biological and chemical weapons,” he says, so “we ought to be racing to stop them.”

Some have started to listen. At last June's annual G8 summit (the Group of Seven leading industrial countries plus Russia), Mr Bush pledged a further $10 billion over the next ten years, and won a collective matching promise from the Europeans, Canada and Japan. In preparation for the next summit, at Evian in France, a group of think-tanks from North America, Europe and Japan, led by the Washington-based Centre for Strategic and International Studies (CSIS), this week passed judgment on the G8 effort so far. Could do better, was their considered report. Finding the cash to meet last year's promises has proved to be one problem (the G8 fund is still about $6 billion short), but not the only one.

More cash can get some things done more quickly. Sites containing around half of Russia's weapons-usable uranium and plutonium still await security upgrades. So the report calls on the Europeans, slow to open their purses (America spends more on co-operative threat-reduction in a year than Europeans have over the past ten, points out one impatient American official), to pay for the work at Russia's civilian nuclear sites, leaving America free to hurry up work at trickier military ones. It also argues for speedier consolidation of Russia's nuclear warheads: some 20,000 are still scattered over more than 120 sites.

But the G8 initiative is still struggling to get up to speed. Who does what is to be co-ordinated by a group of senior government officials; they have yet to agree how to go about it. Russia needs to sort out tax, legal and bureaucratic problems that hold up projects, although progress is being made now that President Vladimir Putin has put his prime minister on the case. And the CSIS report calls on Congress to grant Mr Bush permanent authority to waive conditions attached to some of America's spending. A temporary waiver recently allowed work to go forward on a plant to destroy Russia's stocks of deadly nerve-gas, but the future of the project remains in doubt.

Once the cash and the red tape are sorted out, the next step, argues the report, is to turn Russia from cap-in-hand recipient into full partner, to ensure that a proper “non-proliferation culture” takes root there. That is already proving problematical. Mr Putin wants $3.9 billion of the G8 money to help finance the final dismantling of decommissioned Russian nuclear submarines; his advisers (evidently good students of how Congress operates on its own turf) think this will help his re-election prospects by cleaning up huge environmental problems in Russia's north-west and its far east. It may be the price outsiders have to pay to get down to more urgent non-proliferation business.

Unless there are some worthwhile projects ready to go by the time the G8 meets again, in six months' time, it may prove hard to expand the effort, as originally intended, to draw in new donors and new recipients. Highly-enriched uranium is used in some 100 nuclear research reactors and other facilities in 40 countries. Last year the Nuclear Threat Initiative, a private American foundation that also sponsored

the CSIS report, helped to finance the removal to Russia of 2.5 bombs' worth of the stuff from a poorly protected reactor in Belgrade. There is plenty more of that work to be done. But it is high time, says Mr Nunn, that more governments got in on the act.

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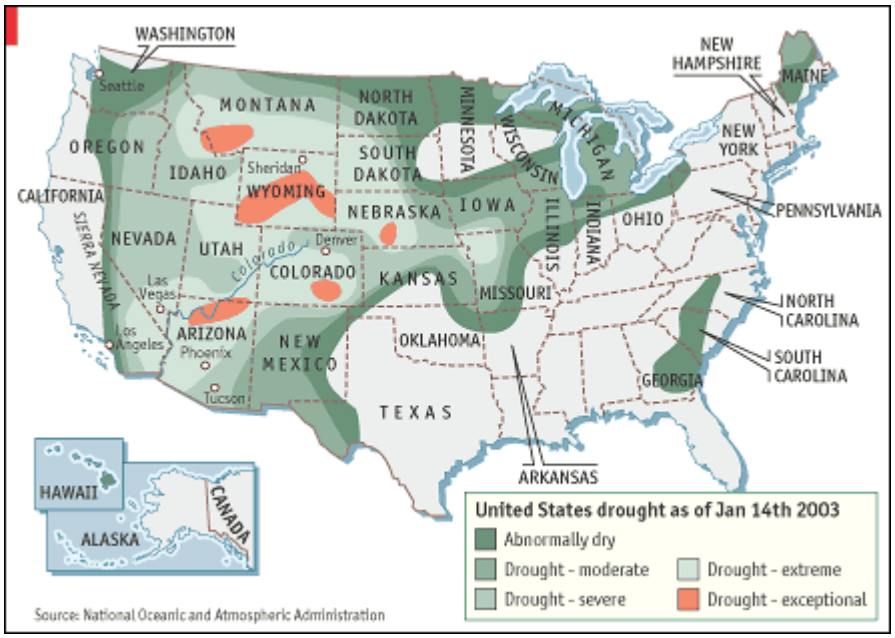
The western drought

A growing thirst

Jan 23rd 2003 | SHERIDAN, WYOMING
From The Economist print edition

Cities can cope better than rural places, but both need better ideas

IN 2002, Arizona, Colorado, Utah, Nevada and Wyoming had the driest or near-driest summer since meteorologists began taking notes more than a century ago. By October, Los Angeles had had only 1.61 inches of rain. November and December delivered five more inches, but the total was far below the average of 15 inches a year. The Colorado river ran at 14% of its normal flow, a 100-year low. And many think there is worse to come.



Drought is no stranger to the west, but each visit is more punishing. Previously reliable water-sources, such as aquifers, are shrinking; populations are growing; American Indian water rights are more strictly enforced; endangered species are more fiercely protected. In previous droughts, cities and irrigators simply built more dams, dug deeper wells, sliced wider canals and diverted streams. Few such options are available today.

Los Angeles, Tucson, Phoenix and Las Vegas own some of the world's largest water-delivery systems. They take drought in their stride, juggling supply lines, enforcing conservation and punishing water-hogs and scofflaws. Phoenix, which is suffering its worst dry spell since 1904, hopes to get by with a mandatory 5% reduction in water use (less sprinkling of golf courses, more mending of leaks) and a shift in supply from the Salt River Project, which is reducing water deliveries to the city by a third, to the Central Arizona Project.

AP

Drought is much more troubling in the non-urban west. Winter Livestock Sales of La Junta, Colorado, which usually sells 200,000 cattle a year, sold 260,000 in 2002, “absolutely due to drought”. Ranches are closing down at a much higher rate than usual. Non-farming communities suffer too. Even wide-open New Mexico has counties that have grown by over 30% during the past decade; and when new people settle in remote places, drought hits them harder.

How hard, though? A 2000 study by Henri Grissino-Mayer, a scientist at the University of Tennessee in Knoxville, suggests that the past two centuries have in fact been the wettest period of the past 1,500 years in New Mexico. The past 20 years have been the wettest of all. Mr Grissino-Mayer based his findings on tree-rings from 248 Douglas firs and ponderosa pines from west-central New Mexico, which clearly record drought or plenty.

The scene in South Dakota

Yet the past has proved a poor guide to future weather patterns in the west. At the time of the 1922 Colorado river compact, hydrologists extrapolated future water flows from 18 very wet years. They told politicians that the river was certain to average 17.5m acre-feet a year; it has averaged 11.7m acre-feet, and the west squabbles constantly over the difference. “If we think the rainfall we got in New Mexico during the 1980s and 1990s was normal, we're in for a rude awakening,” says Charlie Liles of the National Weather Service.

Climatologists are worried, too, by a recent northward shift in the Pacific Decadal Oscillation (PDO), a pattern of warmer or colder weather on a 25-year cycle. This new phase, which is causing Seattle's rain to fall over Alaska, means even more dry years for the rural west, according to Bill Patzert, an oceanographer at the Jet Propulsion Laboratory. The rain of the immediate future, he says, will largely fall in the wrong places: on central Los Angeles, for example, rather than over the Sierra Nevadas and the Colorado river watershed, which send water to the rest of the region.

The inland west knows that it must adjust to dry times rather than look for more water. Colorado thinks it has at least one answer. Researchers at Colorado State University and the University of Colorado are teaming up to create a project called DroughtLab. This will analyse rainfall patterns, track the way water managers and federal range managers are responding to the drought, and keep a watch on both erosion and forest fires. Better data will certainly help; but in the end, of course, there is no substitute for more rain.

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Measuring segregation

Take it block by block

Jan 23rd 2003 | CHICAGO
From The Economist print edition

A new study finds there's still a lot of it, but not where you thought

HOW do you measure segregation? Back in the 1960s, when racial tension was high and Americans were anxious to know how badly divided their country was, the husband-and-wife team of Karl and Alma Taeuber published a book called “Negroes in Cities”, introducing their “segregation dissimilarity index”. This was essentially a comparison of residential segregation between blacks and whites in various American cities.

The Taeubers' index continues to influence the way people think of different cities. But now two academics at the University of Wisconsin at Milwaukee (UWM) have taken on the Taeubers. In a paper rather plonkingly called “Racial Integration in Urban America: A Block Level Analysis of African-American and White Housing Patterns”, Lois Quinn and John Pawasarat, of UWM's Employment and Training Institute, argue that indices which rank whole cities in black-white terms are obsolete, and biased towards an “even dispersion” of blacks in a city.

Not-so-mean streets

Most integrated metropolitan areas, 2000
Black and non-Latino white population

Ranking (based on residential integration*)		% of total pop residing on integrated streets*	% black pop in metro area
1	Norfolk, VA	38.6	31.5
2	Columbia, SC	33.5	32.3
3	Charleston, NC	32.2	31.1
4	Richmond, VA	26.4	30.5
5	Memphis, TN	23.5	43.6
6	Raleigh, NC	23.1	23.0
7	Charlotte, NC	21.5	20.7
8	Jacksonville, FL	20.9	21.9
9	Wilmington, DE	20.3	18.2
10	Little Rock, AR	20.2	22.2
24	Indianapolis, IN	13.7	14.4
43	Milwaukee, WI	9.1	16.0
73	New York, NY	4.7	23.8
89	Los Angeles, CA	2.5	10.0
97	Orange County, CA	0.1	1.8

*Where a street's residents are at least 20% black and 20% white
Source: University of Wisconsin at Milwaukee

Ms Quinn and Mr Pawasarat scoff at the notion that a single number can sum up the complexity of a city's racial integration. And they claim that the Tauebers ignored other minorities, such as Latinos, Asians and American Indians. They then offer a black-white ranking of their own (which also, however, ignores other racial groups).

The new study focuses on black-white integration, not segregation. Using data from the 2000 census, the UWM pair examined all America's 8.2m blocks, the smaller units into which cities and country areas are divided. They chose blocks rather than bigger units, such as census tracts (though some rural blocks are enormous), because, they say, these provide a better measure of interaction between races. As Ms Quinn puts it, “That's where you mow the lawn, you shovel the snow, and the kids play together.” They counted how many blocks were “black-white integrated”, meaning that their population was at least 20% white and 20% black.

Their conclusion that most of America remains racially segregated—almost a third of blacks and more than half of whites live in blocks whose inhabitants are at least 90% of their own race—is not surprising. But their assessment of black-white integration in specific places is startling. Metropolitan areas such as St Louis, Birmingham, Philadelphia and Indianapolis, which rank near the bottom on the old indices, come out in the top third on a block-by-block ranking. Others previously praised as less segregated, such as Albuquerque, Honolulu and Orange County, drop to near the bottom, partly because they have relatively few blacks.

Ms Quinn admits that it was Milwaukees's low ranking in the old lists that stirred local politicians, and the Helen Bader Foundation, to support the study she and Mr Pawasarat have produced. No surprise, then, that Milwaukee comes out a lot better the way they judge things.

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Black and white at school

It's getting worse again

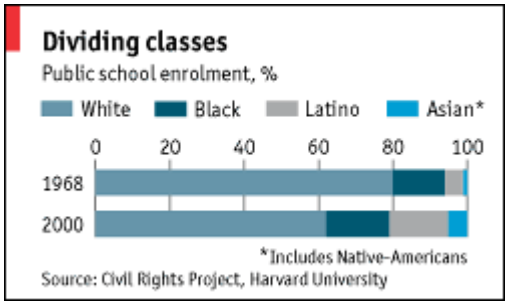
Jan 23rd 2003
From The Economist print edition

How a change for the better went into reverse

WHEN you look at racial segregation in America's schools, another new study—this one from the Civil Rights Project at Harvard University—presents a bleaker picture. The Harvard report, by Erica Frankenberg, Chungmei Lee and Gary Orfield, produces some discouraging figures from the country's public—state-run—schools.

After the schools began desegregating in the mid-1950s, they became steadily more integrated until the late 1980s; but then the trend slowed down, and went into reverse. Now two-fifths of all public-school pupils are non-white (see chart). A ninth of all Latino students, and one-sixth of black students, attend “apartheid schools”, as the report calls them, that are almost 100% non-white. On average, white children go to schools that are 80% white.

Segregation is worst in the largest city school systems, where enrolment is now overwhelmingly non-white. Yet it is also a problem in the suburbs, where schools once largely white are now mostly black or brown. As the minorities move out from the city centres, whites move even farther out. To achieve desegregation, children were once moved by bus between school districts; but a Supreme Court decision of 1974, blocking desegregation in suburban Detroit, began the end of the practice. By 1994 Detroit had the highest level of between-district segregation in metropolitan areas. As the report shows, schools now closely follow housing patterns; if these are heavily segregated, the schools will be too.



The report's most striking finding, however, is the emergence of Latinos both as the fastest-growing minority and the most segregated one. There are now 7.5m Latinos in the public schools, catching up with the 8m blacks. In Florida alone, Latino enrolment in the past 30 years has grown by more than 600%. They are divided from whites and blacks not only by race but also by poverty and language. They also do worst at school, with the highest drop-out rates. Because they were unimportant then, Latinos were not included in most of the court-ordered desegregations of the 1960s. Their presence now is worrying proof that racial segregation in the schools will get worse before it gets better.

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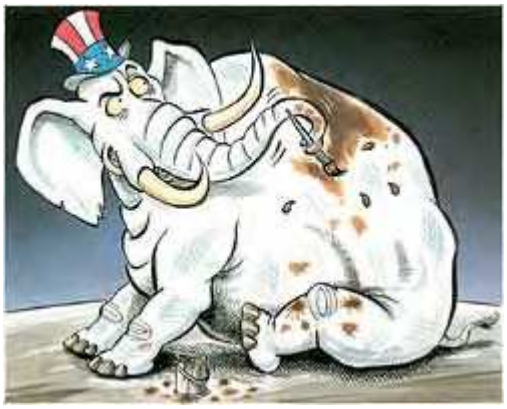
Lexington

The colour of conservatism

Jan 23rd 2003
From The Economist print edition

The Republican Party is still mostly white, but it need not be



GEORGE BUSH is no fan of human cloning. But he may be forgiven for having second thoughts in the case of Armstrong Williams. A fourth-generation Republican, Mr Williams is such a fan of Mr Bush that he has a red, white and blue picture of him hanging outside his office. And he is such a dedicated opponent of affirmative action that he is almost permanently on the airwaves railing against it. Mr Williams is also black.

Mr Bush is determined to put a multicultural face on his party. He seldom appears in public without being flanked by non-whites. He repeatedly mentions the need to make amends for past mistakes. Blacks have reached higher positions under Mr Bush than they did in the diversity-obsessed Clinton administration (though Latinos have not).

But Mr Bush is learning that race remains America's thorniest issue. In December, Trent Lott inadvertently reminded America that the Republicans rose to power in the South thanks to a white backlash against civil rights. The Supreme Court's decision to take a look at the University of Michigan's affirmative-action programme is reminding America that race also influences one of the most vexed issues of all: who gets ahead.

How well has Mr Bush dealt with these two problems? The great merit of his approach is its consistency: in both cases, he has put the principle of colour-blindness first. In the Lott affair, this paid off: Mr Bush not only got his friend, Bill Frist, appointed leader of the Senate, but also neutralised an issue that the Democrats had hoped to use against him in the forthcoming election. But in the affirmative-action case he may not be so lucky.

Mr Bush rightly argued that an admissions policy that awards 20 points for the right skin colour but only 12 for a perfect Scholastic Aptitude Test (SAT) score is a travesty of justice. But his stand is revealing deep divisions within his administration, with Colin Powell publicly distancing himself from the White House. It is also focusing attention on what the Republicans plan to do to improve opportunities for America's minorities.

Mr Bush also has to deal with more deep-seated barriers to making the Republicans more inclusive. The first is that the party has almost no roots in minority America. Though Latinos—now America's largest minority—might be thought to be naturally conservative, the Republican Party on Capitol Hill boasts only four Latinos (two of them brothers), and no blacks. The Democratic Party has 64 minority faces. Minority politicians naturally gravitate towards the party that rules their neighbourhood. Minority voters naturally focus on the party that can make the most practical difference to their lives.

Can the Republicans do anything to change this? It looks doubtful. After the 1990 census, the Democrats carved out several “majority-minority” districts in order to increase the number of blacks in Congress. The Republicans allowed them to do this in order to create more safe Republican districts—especially in the South—in which blacks scarcely feature. After the 2000 census, which revealed the staggering growth in the Latino population, both Democrats and Republicans crafted districts with Latino majorities (in Arizona and Florida). But Republicans know that Latinos are still largely in the Democratic camp, especially in California, where Republican campaigns against immigration have seriously damaged the party.

The second problem is that the Democrats will fight like hell to hold on to minority voters, who are the only people saving the party from oblivion. They are likely to keep the loyalty of most blacks, who have never shown much sign of defecting; and blacks remain electorally the more important minority, looming larger in America's moral imagination and mattering more in swing states. Large numbers of Latinos, besides, are illegal and cannot vote. But if Republicans cannot woo and win Latinos either, they had better reconcile themselves to long-term decline.

So far, Mr Bush's wooing has not been entirely fruitless. He won more than 40% of the Latino vote when he ran for re-election as governor of Texas. Success of this order with minorities helps him to get along with moderate whites, too. And meanwhile the number of middle-class minorities, both Latino and black, is growing relentlessly.

The bigotry of low expectations

But Mr Bush needs to be bolder if he is to shake up long-established allegiances. Why should minorities abandon a party that fought for civil rights in favour of one that exploited the backlash against them? And why should they abandon a party that believes in entrenching racial preferences in favour of one that believes in dismantling them? Not because of some vague waffle about replacing “quotas” with “outreach”. You need to give them something worth getting excited about.

That something might well be school vouchers. The biggest barrier to minorities getting ahead in America is the wretched state of the country's public schools—particularly public schools in the inner cities, which are increasingly resegregating (see article). No amount of affirmative action can make up for 12 years of lousy education. School vouchers are the best way to force poor schools to perform better; they are also the best way to give poor people more control over their own lives.

Mr Bush has a perfect opportunity to experiment with vouchers in his own backyard. Washington, DC, is the epitome of what he once termed “the soft bigotry of low expectations”. Almost two-thirds of Washington's ten-year-olds cannot read with any degree of understanding, and the district sits near the bottom of national education rankings. Poor Washingtonians—most of them black—are crying out for change. Several congressmen have already drawn up detailed voucher plans. Is there any better way of making the minorities take Mr Bush seriously than to salvage the schools in the nation's capital?

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Mexico and the United States

Half an enchilada

Jan 23rd 2003 | MEXICO CITY
From The Economist print edition

EPA

At the top, Mexico's relationship with its big neighbour is stalled. But strong forces are driving it forward from below

Get article background

SINCE September 11th, 2001, Latin Americans have grown wearily used to their giant northern neighbour looking east instead of south. Nowhere is this more true, or more resented, than in Mexico. Only two years ago Vicente Fox had high hopes that his personal rapport with George Bush would help to turn the North American Free-Trade Agreement (NAFTA) into a broader scheme to integrate their two countries. Those hopes have been well and truly dashed, as the resignation earlier this month of Jorge Castañeda as Mexico's foreign minister seemed to underline.

Mr Castañeda had set his sights on a comprehensive immigration accord to safeguard the rights of the estimated 10m-12m legal and illegal Mexican immigrants in the United States— the “whole enchilada” as the Mexican foreign ministry called it. A slowing American economy made this hard; the terrorist attacks made it impossible. Mr Castañeda's frustration at his inability to make any headway with this cornerstone of President Fox's foreign policy was a big reason for his departure.

There are other irritants. On January 21st, Mexico asked the International Court of Justice to rule against the execution of 51 Mexicans on death row in American jails. Mexico argues that the United States has violated international law by failing to inform or grant access to consular officials when Mexican migrants are arrested or sentenced to death. Last year, Mr Fox cancelled a visit to Mr Bush's Texas ranch in protest at the execution of a Mexican.

Feelings against America have also been exacerbated by the elimination on January 1st of tariffs on a host of agricultural products in accordance with NAFTA. Mexican farmers are angry at what they see as a treaty unfairly weighted in favour of their subsidised American counterparts. They have confronted Mr Fox, a pro-American former Coca-Cola manager, with three weeks of protests.

Such disputes inflame an anti-Americanism that has deep historical roots in a country which suffered several invasions by its northern neighbour, losing 40% of its territory. Even now, most Mexicans see Americans as arrogant. Mund Americas, a polling firm, found last month that 77% see the United States as “trying to dominate the world” while only 22% believed it plays a “constructive role in world politics”. But Mund's polling also finds a growing acceptance of day-to-day contacts with Americans. That points to a new trend.

Mexico's relations with the United States have long been a complicated mosaic of conflict and co-operation. While matters might be stalled at the diplomatic level, on the ground things are sometimes very different. Take migration. As politicians in Washington do their best to ignore the issue, in practice big changes are taking place. They are being driven from the bottom up, by business and local political interests in the United States.

Claudia Torrescano, a Mexican community leader in Dallas, Texas, argues that the key date in the migration debate is not September 11th, but April 2000, when the American census took place. This showed that Latinos were poised to overtake blacks as the largest minority in the country. (They now have, reaching 37m, according to an estimate by the Census Bureau this week.) In the Dallas/Fort Worth area alone, a third of the population was identified as being of Hispanic descent; most of these (about 1m) are Mexican.

Businessmen quickly realised the opportunities. For example, last year Mexicans in America sent back about $11 billion in remittances to their families south of the border, with $2.5 billion flowing from Texas alone. Most of this money traditionally went through expensive telegram transfers, or in cash by trucks (for a 10% commission). Here was a service that banks could provide to millions of new customers at a much lower cost—but only if they could provide the official identification required to open a bank account, which illegal immigrants lack.

So Mexico's government stepped in. In 2001, it began issuing a new, forgery-proof consular registration card, proving residence in America. These have been very popular: Mexican consulates issued 1.1m last year. They are now recognised by 80 banks. Other businesses have followed: the cards are now accepted by internet cafés, the insurance industry, and car salesmen. In some states, illegal immigrants can use them to get driving licences. The cards are also recognised by hundreds of police departments around the country.

All of this is bringing millions of Mexicans into the mainstream of American commercial life for the first time, as well as allowing them to move into better jobs. Some Americans complain that this rewards illegal immigration. This week, bowing to protests, the General Services Administration announced that the cards can no longer be used to gain admittance to federal buildings until an investigation into their authenticity is carried out.

But many American businessmen welcome the cards. They allow a “larger pool of workers with the skills that are needed for us to stay competitive,” says William Buick, one of Dallas's biggest property developers. And banks are keen to sign up the 50% of Mexicans in the United States who still lack accounts.

Even if it is not checked, this falls short of the “whole enchilada”. Instead, progress on migration is by “lots of baby steps”, argues Ezequiel Padilla, Mexico's consul in Dallas. On other issues, too, not all is gloom. An interim deal has been struck in a water dispute with Texas. Under Mr Fox, trust between drug-fighters on each side of the border has increased. In the long run, it is such everyday co-operation, rather than presidential diplomacy, that may produce deeper integration. It might even mean that Mexicans and Americans start to like each other more.

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Argentina's economy

The IMF climbs aboard

Jan 23rd 2003 | BUENOS AIRES
From The Economist print edition

Next stop: tackling debts and judges

Get article background

SELDOM, if ever, have the IMF's staff given their seal of approval more grudgingly. In recommending a $6.6 billion loan to Argentina to cover repayments of past debts due to the Fund itself over the next seven months, Horst Köhler, the IMF's boss, warned his political masters of the “exceptional risks” they were taking. Even so, the IMF's board was expected to approve the loan on January 24th. For Roberto Lavagna, Argentina's economy minister, that vindicates some tough tactics (of threatening to default on debts to the IMF, and doing so to the World Bank) and rewards his country's emerging, if fragile, stability after last year's collapse.

But now the hard work starts, for President Eduardo Duhalde and for whoever wins an election to replace him due in April. Prospects for recovery turn on three main issues: restraining pressures for public spending, cleaning up the country's banks, and reining in maverick judges. All are linked, and between them hold the key to whether banks start lending again, allowing the economy to start growing rather than merely to stop collapsing.

There are some hopeful signs. Mr Lavagna has removed many of the curbs on bank deposits imposed by his predecessors. Now, only a fifth of deposits are frozen; this week banks paid back the first tranche of a bond that replaced some deposits. Contrary to the dire prophecies of many who said that Argentines would steer clear of banks for years, many have swiftly redeposited their money.

The banks have liquidity once again, but their solvency is another matter. Many of their assets are in bonds on which the government has defaulted. So the government has to restructure its debt (which totals around $100 billion) before banks can clean up their balance sheets. The Economy Ministry is due to announce next week the appointment of an investment bank to advise it on the debt renegotiation. The haggling could take up to two years. Investors expect the value of the debt to be written down by half. But even this lightened burden will require the government to crank out a larger budget surplus. But perhaps the biggest threat comes from the judges. The Supreme Court is due to consider the government's decision a year ago forcibly to convert dollar deposits to pesos. Overturning this would be a near-fatal blow to the banks.

Taming the courts was one of the main demands that IMF staff made of the government. Unfairly so, complain Argentine officials, who argue that the courts are independent. Up to a point: a recent poll found that 97% of Argentines do not believe that they are. But the problem for Mr Duhalde is that the Supreme Court depends not on him but on his closest enemy in the ruling Peronist party, Carlos Menem. When president in 1990, he enlarged the court to create an “automatic majority” which rubber-stamped his decisions. Mr Menem is now seeking to return to power in April's election.

Mr Duhalde tried to get the court impeached. He narrowly failed; but this reinforced the judges' old political loyalties. When Mr Menem forcibly turned bank deposits into bonds in 1990, many of the same judges sat on the Supreme Court, which approved the plan. Now, in a preliminary judgement, the court supported redollarising deposits. This inconsistency stems from Mr Menem's desire to see Mr Duhalde's economic policy fail, argues Rafael Bielsa, a constitutional lawyer.

The government is seeking to delay a ruling as long as possible, so that most of the deposits at issue will have been withdrawn and spent. It is also keen to avoid any judgment before the election. Whatever the outcome, the next government will confront a politicised judiciary. And that may be the biggest obstacle of all to Argentina's recovery.

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Venezuela's stand-off

Friends and foes

Jan 23rd 2003 | CARACAS
From The Economist print edition

New efforts to bridge a chasm

Reuters

The Bolivarian revolution? It's him

IN THE eighth week of an opposition-led strike aimed at toppling President Hugo Chávez, Venezuela slipped a little closer to autarky. On January 22nd, the central bank bowed to the inevitable and suspended currency trading for five days, pending the introduction of exchange controls. The bolívar has lost 28% of its value so far this year as exports slowed to a trickle and demand for dollars soared.

Inevitable, but nevertheless unwelcome for Mr Chávez, a sworn opponent of exchange controls. He has also claimed to have no quarrel with foreign capital, just with local “oligarchs”. But several multinationals pulled their expatriate staff out after Mr Chávez sent troops to “liberate” a strikebound Coca-Cola plant, owned by a Mexican bottling company.

The opposition claims that Mr Chávez, a former army officer who was twice elected, is ruling as a dictator. His opponents are “fascists” retorts the president. He is sticking to the letter of the 1999 constitution he fathered, which allows a mid-term recall referendum, but not until later this year. The Supreme Tribunal this week quashed a plan for an earlier referendum.

Mr Chávez claims that his “Bolivarian revolution” is triumphing. The strike is indeed starting to fray: some shipping pilots returned to work this week. But it remains solid where it hurts most, in the oil industry. And that has prompted new international efforts to try to bridge the chasm that divides the two sides.

For more than two months, César Gaviria, the secretary-general of the Organisation of American States (OAS), has tried fruitlessly to broker a settlement. His mandate allows him only to “facilitate”, not propose. So this week Jimmy Carter, a former American president, suggested two ways out: either a firm date for a referendum in August, or a constitutional reform to shorten Mr Chávez's term from six years to four, with an election next year.

Neither scheme is new, but their timing is interesting. On January 24th, foreign ministers from a newly formed group of “friends of Venezuela” are due to meet in Washington. This initiative was proposed by Brazil's president, Lula da Silva, who is friendly to Mr Chávez. It was first rejected, but then adopted by the United States. None of the other four members (Chile, Mexico, Portugal and Spain) is a fan of the “Bolivarian Revolution”. A bid by Mr Chávez to expand the group—to include allies like Algeria, China, Russia and France—was turned down by Brazil.

Even if the group were to adopt Mr Carter's ideas, it is not clear whether either side would accept them. The opposition will want reinstatement for the oil-industry strikers, and guarantees that any vote will be fair. Mr Chávez has shown no intention of surrendering power. The diplomats may be in for a long haul.

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Drugs in Bolivia

Coca and socialism

Jan 23rd 2003 | LA PAZ
From The Economist print edition

A baptism of fire for the government

IT HAS almost become a ritual. Ever since 1987, when Bolivia, at the urging of the United States, adopted a tough anti-drug law, coca farmers have staged regular protests against the forcible eradication of their crop (from which cocaine is made). This month, they have done so again—but this time with deadly results.

The protesters pushed trees and rocks to block roads in the lowland Chapare region, the main cocaine-producing area. In the clashes with police and army troops that followed, six protesters died while more than 50 people from both sides were wounded by rocks and bullets. Then sharpshooters killed a soldier and wounded three, just as a small group of lightly armed Andean Indians summoned reporters to announce that they had formed a new guerrilla group, the Army of National Dignity, to join the fight.

President Gonzalo Sánchez de Lozada, who took office last August, vowed to prevent “a fiesta of protests”. But he also offered an unusual carrot. The farmers want an increase in the area where coca can be grown legally for “traditional” uses (such as for chewing or tea), an end to compulsory eradication, and changes in the anti-drug law. The government offered to appoint independent researchers to carry out an annual study of the legal coca market. If demand is greater than thought, then the government would increase the current legal area of 12,000 hectares (29,640 acres).

But Evo Morales, the leader of the coca workers' union, wants an immediate halt to eradication and the withdrawal of the police. Neither is acceptable to the government. Nowadays, Mr Morales feels he has clout—and he has broader ambitions. He came second in last year's election, and his Movement to Socialism leads the opposition in Congress. It is campaigning against the proposed Free-Trade Area of the Americas, and also against a plan to export natural gas through Chile to the United States.

These campaigns are gaining wider support. Guerrillas have never thrived in Bolivia. But trade unions have. Still fairly strong, they are planning to join the protests. Mr Sánchez de Lozada is a shrewd political veteran; in his first term as president, from 1993-97, he pushed through liberal reforms. This time, his mandate is weaker. His first five months were surprisingly quiet. Now the noise has begun.

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Violence in Brazil

City of God and gripes

Jan 23rd 2003 | RIO DE JANEIRO
From The Economist print edition

Why one drug gang is less bad than two

"CIDADE de Deus", the film, is a smash. Millions of Brazilians saw the tale of gang wars in a Rio de Janeiro *favela* (slum), as close as many ever get to such a place. In the United States, where it opened last week as "City of God", it is attracting much notice, as it has in Britain. Cidade de Deus, the place, is another matter. "The film got everything wrong," says a woman who has lived in the *favela* since it was created in 1966 as a repository for some of Rio's poor, at what was then a safe distance from fashionable parts of town.

Conditioned by the film to expect desolation, a visitor's first shock comes from ordinary things, such as the Carrefour supermarket. The main grumbles of the locals are prosaic: unemployment, overflowing sewage and generally lousy public services. Some now add the film: it has turned their stigma global, and made employers nervous. Drugs are not their main vocation, nor murder their children's' rite of passage, they insist.

But neither does the film seem so wide of the mark. If the place is quieter than the movie that is partly because the war it depicts took place in the 1970s and 1980s, and is over, at least for now. Today Cidade de Deus, with 80,000 people, is run by *Comando Vermelho* (Red Command), one of Rio's main trafficking gangs. That makes it relatively lucky. In many of Rio's 800-odd other *favelas*, home to 1m people, bystanders are caught between rival gangs. The main hazard in Cidade de Deus is occasional battles between traffickers and police.

Ask the commander of the local police who controls the place and he responds: "I do." But in its lanes, shirtless young men strut about with guns; drugs are sold from covered stalls. The policeman says about 200 people are involved in trafficking. But a charity worker guesses that the trade employs half the young men. Many will die young.

Rather than the traffickers, locals are quicker to criticise the police, who, they allege, fight the traffickers only to extract more bribes. Last month, three officers were arrested for corruption. But this politeness about the traffickers merely shows that the goodwill of armed adolescents is brittle and conditional. "You can't speak ill of the *bandidos* but you can say anything about the state," says one resident. The war for Cidade de Deus may be over, but the fear remains.

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China

Roll over, Confucius

Jan 23rd 2003 | BEIJING
From The Economist print edition

Education in China is being overhauled in the name of creativity. But will the changes also breed dissent?

THROUGHOUT the millennia, students of all ages in China have had to endure the miseries of learning by rote. Teachers have stifled creativity in the pursuit of the accumulation of facts, and parents have forced children to spend mind-numbing hours cramming for exams. But for the past year, the government has been experimenting with what could amount to revolutionary changes in China's classrooms. The aim is to make education more pleasant, more useful and, above all, to challenge students to think for themselves.

What has prompted the reforms is a belated recognition that China's education system is failing to produce enough innovative thinkers. In addition, students are deeply unhappy. A survey conducted by the Education Ministry five years ago found more than 80% of students disliked school. Dropout rates have been rising in rural areas—partly for economic reasons but also because of the stultifying atmosphere of their classrooms. Exam pressures frequently lead to suicides. According to a survey last year among senior secondary-school students and university freshmen in one area, more than 50% had considered killing themselves.

Several other countries in East Asia, including Japan, South Korea and Taiwan, are grappling with similar problems. But the implications of China's reform efforts are particularly profound. China's traditional education methods are ideally suited to a political culture that requires citizens to submit blindly to authority. By encouraging students to question their teachers and regard them as equals (even official literature now talks of fostering a “democratic” atmosphere in classrooms), China could be ushering in a new kind of relationship between the rulers and the ruled.

The problem is making it work. The government has set ambitious targets with few resources to ensure that the country's more than 10m primary- and secondary-school teachers acquire the skills and determination to change the habits of a lifetime. The reforms started in September 2001 with about 420,000 primary- and junior secondary-school students (out of a national total of more than 215m) taking part in 38 experimental zones around the country. In September this year, participation increased to 9.1m pupils in 572 zones. These figures will double next year. The Education Ministry's original idea had been to implement the reforms nationwide by 2010. But according to Liu Jian of the ministry's National Centre for School Curriculum and Textbook Development, employers from a variety of enterprises said they wanted a quicker timetable. So now the target is 2005. In 2004, similar experiments will start in secondary schools.

Some of the reforms involve introducing livelier textbooks. In elementary mathematics, for example, these try to relate formulae to practical situations. New English textbooks encourage pupils to experiment with dialogue instead of simply memorising words and phrases. (In China, students who perform well in English exams are often barely able to speak it.) According to Education Ministry materials, teachers are expected to use these textbooks simply as “platforms” for imaginative classroom exercises instead of treating them as “sacred texts”. All this, however, costs money.

Mr Liu of the Education Ministry estimates that providing on-the-job training for teachers could cost $1.5 billion. This will not come from the ministry but from local education departments. But these are already facing acute budgetary problems, particularly in the countryside where some teachers go unpaid for

months on end because the township-level governments responsible for rural schools have run out of money. “We very much want to send teachers elsewhere for training,” a secondary-school headmaster from Inner Mongolia, Kong Xiangwei, complained to colleagues at a recent conference in Beijing. “But we don't have the money. It costs us a lot just to attend this conference, and when we go back it could be impossible to reclaim our expenses.”

On top of this is the problem of convincing parents that new-fangled education methods are going to benefit their children. As long as the entrance requirements for universities and senior secondary schools remain based on the results of national exams which primarily test students' ability to memorise, parents will pile on the same pressures. At the Guangming Primary School in Beijing, an early pioneer of the reforms, pupils are asked to submit comments on their teachers twice a term. “They say they want us to be stricter, but that's because their parents tell them to say that,” says Lu Jie, an administrator at the school. Other parents are less restrained. According to Mr Kong, from Inner Mongolia, some have been withdrawing their children from schools where reforms are being carried out.

Although most schools in China are still state-run, many now in effect operate as private institutions—charging fees (often euphemistically described as “donations”) as high as the market will allow. Schools that have a good record of getting pupils into top universities are obviously in the greatest demand. There is therefore a considerable risk that schools will pay lip service to the new reforms while continuing to cram students in the time-honoured fashion. Officials also worry that provincial education authorities, in order to protect local publishing industries, will deny schools any choice in their selection of textbooks (freer choice of teaching materials being one of the aims of the reforms). “It is possible that by 2005 everyone will be using new teaching materials, but the actual impact will fall far short of what's required,” says Mr Liu.

Mr Liu says the long-term plan is to change the university entrance procedures to place more emphasis on students' performance at school rather than simply on the national entrance exam. He suggests this will be necessary by 2007, when the first students educated by the new methods will reach university. But the problem is how to assess such performance fairly, given the likelihood of corruption. In a country awash with fake diplomas and graduation certificates, the nationally administered university entrance exam, for all its faults, is one institution that is at least respected. “We will face a lot of pressure, but we have to keep going,” says Mr Liu. “Changes in the curriculum are creating a new culture in the classroom that is open, scientific and democratic.”

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China and Taiwan

To boldly go

Jan 23rd 2003 | BEIJING
From The Economist print edition

Taiwanese planes are flying to China—in a roundabout way

Get article background

THE first authorised flight by a Taiwanese aircraft to mainland China since the end of the Chinese civil war in 1949 is due to take place on January 26th. Sadly, the breakthrough will not be quite as dramatic as it sounds.

The China Airlines flight will be the first of 16 Taiwanese charter services scheduled to land in Shanghai during the two weeks of the lunar new-year celebrations. Under pressure from businessmen and politicians, Taiwan's government decided to allow the flights in order to help some of the many Taiwanese working in China to return home for the holiday.

But at Taiwan's insistence, the planes will still have to touch down in Hong Kong or Macau on their way from Taiwan to Shanghai—adding three or four hours to what should be a less than 90-minute journey across the Taiwan Strait. Taiwan still bans direct aviation links with the mainland. Although Hong Kong and Macau are part of China, Taiwan regards them as special exceptions because of their supposedly autonomous status. This means that the flights are not deemed to be direct.

It also means that Taiwanese using the charter services will save hardly any time at all. It has long been possible to fly from Taiwan to the mainland via Hong Kong or Macau without changing planes (only flight numbers), as long as an airline controlled neither by Taiwan nor by the mainland is used. Many Taiwanese in China (as many as 300,000 of them live in the Shanghai area) would have booked seats home on regular flights through Hong Kong and Macau long before Taiwan and China reached agreement on the charter services early this month.

The two sides have not agreed to repeat this experiment, let alone to launch direct or regular flights across the strait. Although China last year softened its preconditions for talks on such flights, it refuses to hold direct negotiations with the Taiwanese government. For its part, Taiwan worries that direct flights will hasten economic integration between the sides (making the island more vulnerable to mainland economic pressure), and create security risks by making it harder to detect hostile approaches from the air. Optimists say the agreement on charter flights, which excludes mainland airlines altogether, shows that China is becoming more flexible. But a senior Taiwanese official involved in mainland affairs says it will be “a long time” before direct flights are inaugurated.

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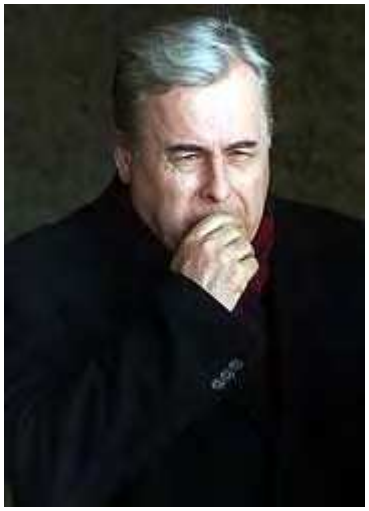
North Korea

Bombs and bribes

Jan 23rd 2003
From The Economist print edition

And now Russia steps in

Reuters



SUDDENLY, plans to end the nuclear crisis on the Korean peninsula seem to be proliferating faster than North Korea can build nuclear bombs. George Bush proffered his “bold initiative” last week, offering the North improved relations with America, including new aid, once it had ended its nuclear dabbling. This week Russia's deputy foreign minister, Alexander Losyukov (see picture), presented its own “peace plan” to North Korea's leader, Kim Jong Il. And representatives of South Korea's president-elect, Roh Moo-hyun, were due to present his new “grand vision”, designed, his aides explained, to turn North and South into a single economic community, at an end-of-week gathering of assorted bigwigs in Davos, Switzerland.

These plans all have two things in common. They all, on the face of it, require North Korea to drop its nuclear plans; and none has yet provoked any sort of official response, not even a raspberry, from the North Korean leadership.

That, together with a slight watering down of North Korea's anti-American vitriol, has led to hopes that a diplomatic way might yet be found out of the impasse that was created last October, when America shocked North Korea by fingering it for having a covert uranium-enrichment programme, and North Korea shocked America by owning up to it. Since then, North Korea has expelled inspectors from the International Atomic Energy Agency (IAEA) who were monitoring a freeze on its earlier plutonium production, restarted work on its nuclear reactors and flounced out of the Nuclear Non-Proliferation Treaty (NPT).

Earlier this week, America's secretary of state, Colin Powell, suggested that some “interesting elements” had emerged from all the diplomatic toing and froing. But nothing that has emerged so far would bridge the gap between North Korea and America. The North insists that the nuclear problem can be settled only in “knee-to-knee” talks with America. America insists that it will talk to North Korea at this stage only about how it can come back into compliance with its various non-nuclear promises, not start horse-trading over them.

This week Mr Powell appeared to step up the pressure by demanding that the IAEA, which has censured North Korea already for its nuclear transgressions, take the next step and bring these to the attention of the UN Security Council. That is America's way of reminding North Korea, and everyone else, that this challenge to the international non-proliferation regime is not America's problem alone to deal with. For its part, North Korea denies that it is building nuclear weapons, although it does not try to argue that its secret nuclear activities are anything but a breach of the NPT, as well as agreements it has signed with both South Korea and America.

In contrast to their attitude to Iraq, China and Russia seem keen to keep the Security Council out of the North Korean issue for now. In the past, North Korea has insisted that any attempt by the council to impose sanctions would be taken as a declaration of war. Mr Powell, however, has been careful not to mention UN sanctions. And Russia has hinted that a multilateral and a bilateral track might be needed to end the stand-off. It has not said whether this might be done under a UN umbrella or a regional one.

Meanwhile North Korea sent an envoy, Kim Ryong Song, to South Korea this week, for talks on economic co-operation. In response to calls from his South Korean counterpart to resolve the nuclear issue before it did more damage, Mr Kim instead called on South Korea to join the North in blocking what he said was

an American plan to “subjugate the whole Korean nation.” Not much give there so far.

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Indonesia

All the spine of a jellyfish

Jan 23rd 2003
From The Economist print edition

AP

The president stands firm—to the first ditch

FOR Megawati Sukarnoputri, Indonesia's president, it was an unusually clear and emphatic statement. Speaking of her determination to maintain cuts in fuel, electricity and telephone subsidies despite public protests, she told nervous members of her political party, “I chose an unpopular but constructive policy for the long run, rather than opting for a populist step that may trouble us further.” But she was back to her old self soon: less than a week later, on January 20th, her government reinstated many of the subsidies.

The timing was particularly unfortunate. The next day, the international agencies that help Indonesia to manage its deficits convened in Bali to decide how much money to lend the country this year. The subsidy cuts had been a critical element in Indonesia's long-term plans to balance its budget. Although the agencies put a brave face on the reversal and agreed to stump up $2.7 billion, many of them must have been worrying about the government's commitment to reform. Rightly so: even as the agencies were making their pledges, Dorojatun Kuntjoro-Jakti, the co-ordinating minister for the economy, was suggesting that Indonesia might soon scrap its co-operation with the IMF.

In fact, the government is still moving in the direction the IMF wants, albeit not at the pace it would like. It did not call off the subsidy cuts altogether, just drastically reduced them. Over the past year, it has slashed Indonesia's public debt from almost 100% of national income to 72%. The fiscal deficit fell from 3.6% of GDP in 2001 to around 2% last year. It is expected to fall to 1.8% this year, even with the reinstated subsidies, thanks to extra revenue from the current high international price of oil.

But affordable or not, the subsidies make no sense, since they benefit the rich more than the poor: 97% of Indonesians do not have fixed-line telephones, and so gain nothing from subsidised call charges. Higher rates, on the other hand, would help finance the expansion of the network. Subsidies on electricity and fuel benefit the owners of big cars, houses and factories, while the government had intended to spend some of the money saved by cuts on schemes to ease poverty.

No Indonesian government can afford to ignore street protests altogether. Mass demonstrations helped bring down Miss Megawati's three immediate predecessors. But the current bout is on nothing like the same scale. If anything, the government's concessions have only made things worse. They look like corporate welfare. They have encouraged the protesters by creating the impression that the government will fold under relatively mild pressure.

Many of the protesters are now demanding the reinstatement of all subsidies, an immediate end to all reforms inspired by the IMF and the resignation of the president. Others direct their ire at Akbar Tandjung, the speaker of parliament, who remains in office (with Miss Megawati's backing) despite having now been convicted twice for corruption. Businessmen, meanwhile, are outraged at the decision to reinstate three judges suspected of taking bribes from a firm in exchange for closing down its rival. To be re-elected in 2004, Miss Megawati will not only have to come up with remedies for all these complaints, but also stick to them.

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Press freedom in Malaysia

Going, going, Gan

Jan 23rd 2003
From The Economist print edition

Censorship reaches the internet

SEDITION, says the youth wing of Malaysia's ruling party, the United Malays National Organisation (UMNO). Everyday political debate, retorts Malaysiakini, a news website that published an anonymous reader's letter decrying special privileges for the country's ethnic Malays. In Malaysian law, however, the difference can be quite slight. On January 20th, prompted by a complaint from UMNO Youth, the police raided Malaysiakini's offices in Kuala Lumpur and confiscated its computers, though six were later returned. Although Malaysiakini is still operating after a fashion, using borrowed computers, the investigation now under way might lead to fines or a jail term for its editor, Steven Gan, or to the closure of the site altogether. It certainly tightens the screws on Malaysia's already fettered media.

Since it was founded in 1999, Malaysiakini has been a thorn in the government's side. Compared with Malaysia's staid press and state-owned television, its reporting is more insightful and its editorials are feistier. At the most recent elections, its readership climbed to about 140,000 people a day (although it has since subsided to around 100,000). UMNO members make no secret of their desire to see the site shut down. Officials exclude its reporters from press conferences. Mahathir Mohamad, Malaysia's prime minister, has even lambasted it as a tool of foreign saboteurs.

AP

Keeping the online in line

The government certainly believes it has the right to control what Malaysians see and hear. Earlier this month, it floated a scheme to vet live radio shows, in a bid to reduce sexual innuendo. Last year it banned a music video for lingering too long on the buttocks of Kylie Minogue, and an episode of “Friends” for encouraging promiscuity. It also axed an entirely chaste advertisement featuring Brad Pitt, on the ground that locals needed Asian role models, not white ones.

Political censorship is almost as crass. Newspapers must renew their licences every year, and cannot petition the courts if the government revokes them. Several critical papers have lost their licences this way, while *Harakah*, the newspaper of the country's biggest opposition party, had its publication and distribution rights severely curtailed. In 2001, a political party allied to UMNO took over two Chinese newspapers, leaving just one in independent hands.

Websites are slightly better off, since they do not need a licence to operate. But Malaysia still has all manner of draconian laws to keep online journalists in line, including the Official Secrets, Internal Security and Sedition Acts. The last (under which Malaysiakini is being investigated), prescribes jail terms

and fines for anyone who excites “disaffection” with the government, the courts or various clauses of the constitution. As sweeping as that sounds, it does not, apparently, apply to the disaffection the government brings upon itself through its heavy-handed treatment of the media.

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Australia

Canberra burns

Jan 23rd 2003 | SYDNEY
From The Economist print edition

Not even the capital escapes the bushfires

TO THE rest of Australia, Canberra has seemed a foreign place. It is one of the world's few planned capital cities, built to defuse a rivalry between Sydney and Melbourne for the honour. Australians blame the seat of government's artificial character for their politicians' being out of touch, and resent the money spent on a city of bureaucrats. Canberra's 320,000 people, richer and better educated than most, have even appeared immune from Australia's everyday problems—until January 18th when bushfires swept into the city killing four people and destroying almost 500 houses in its worst ever disaster.

Walter Burley Griffin, an American architect who won an international competition in 1912 to design Canberra, planned the city's residential areas amid parks and forests, radiating from Parliament House. The fires started in the Namadgi ranges, a popular national park, and engulfed Canberra's south-western suburbs with frightening speed, stoked by drought, heat and searing winds. They also destroyed a world-class astronomical observatory on Mount Stromlo, overlooking Canberra. Towns in Victoria state were also threatened.

This is the third time in 13 months that fires have raged out of control in Australia. The capital has joined the league of misfortune alongside Sydney, Melbourne, Adelaide and Hobart, all of which have suffered devastating fires over the past 40 years. Recriminations followed over which state or national authority to blame. The answer is probably none. The federal government of John Howard has been running an advertising campaign warning Australians to protect their “way of life” from terrorism. But the Canberra fires have shown once again that another threat to Australians' way of life comes from their fragile relationship with nature.

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India

Reinventing Gandhi

Jan 23rd 2003 | DELHI
From The Economist print edition

Congress needs a new plan

THE Congress Party, India's main national opposition, is in a funk. Just weeks ago, it was coasting towards a good showing in the general election due next year, on a tide of disaffection with the government. But a thumping defeat in last month's state election in Gujarat left it adrift, and at war with itself. Congress is in danger of seeming less a natural party of government than an opposition in long-term decline, struggling to put its house in order before more state elections next month, later this year and in 2004.

To that end, the party's leader, Sonia Gandhi, last week engineered the removal of the notoriously ineffectual chief minister of the important state of Maharashtra. Other job shuffles in Congress-ruled states may follow. They will not, however, tackle Congress's underlying troubles.

AP

Time to reclaim the homespun

The victory in Gujarat of the Bharatiya Janata Party (BJP), which leads the national coalition government, followed an aggressive campaign playing on the fears of the majority Hindu population. After violence in the state earlier last year, in which 58 Hindu activists were killed and as many as 2,000 Muslims died in a retaliatory pogrom, it succeeded in portraying Congress as soft on Muslim terrorism. This has raised fears that similar campaigns based on the Hindu-nationalist ideology known as “Hindutva”, or “Hinduness”, might be equally effective elsewhere.

Some Congress leaders, discussing the party's response to the setback, emphasise the BJP's own internal controversies, and their own, mainly personality-based, strategies for garnering votes from various sections of India's bewilderingly diverse population. Policies scarcely figure.

But without them, the party is in trouble. It has offered no clear response to Hindu fundamentalism. In Gujarat, confident of the Muslim vote, it fielded few Muslim candidates and followed what some called a “soft Hindutva” line. This led to accusations that it had become the “BJP's B-team”. Salman Khurshid, a senior party policymaker, says Congress needs to develop a vocabulary that is immune to such attacks, and to find new ways of presenting the party that led India to independence as a secular state: “to reinvent Gandhi”, as he puts it.

A second worry is the party leadership. Manoj Joshi, political editor of the *Times of India*, points out that the BJP, despite its sometimes atavistic message, is a well-organised modern political party. Congress, in its reliance on one family to hold it together, is in comparison positively feudal. In Gujarat, the BJP made much of Mrs Gandhi's Italian origins. It is widely believed that they will also cost Congress votes elsewhere. Yet the party feels it needs her, as a member of the fourth generation of a dynasty that has dominated Congress since its inception—at least until her son or daughter, already flexing their political muscles, are ready.

Mrs Gandhi's handling of the power struggle in Maharashtra at least enhanced her image for toughness. The new chief minister she selected is Sushil Kumar Shinde, a former state finance minister. He is a dalit (a group formerly called the “untouchables”) and Congress leaders hope he will raise the party's standing with lower-caste Hindus across the country. Congress's traditional support among the downtrodden has been badly eroded in recent years by the emergence of powerful lower-caste parties.

The next test for Congress will come on February 26th in elections in Himachal Pradesh, the only one of

four Congress-governed states voting that day where the party will be directly pitted against the BJP. It is a small state, but the result is important for Congress if it is to show that the “Hindutva wave” has crested.

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India

Didn't they do well...

Jan 23rd 2003 | DELHI
From The Economist print edition

The diaspora is "discovered"

AFTER decades of indifference, India has begun wooing the 20m of its compatriots who live abroad. Legislation to allow some of them to hold dual nationality is to come before the Indian Parliament in the next few months, and the government is to invite their representatives to a conference in Delhi every January. An inaugural get-together this month was attended by more than 2,000 non-resident Indians (NRIs) and others of Indian origin from 66 countries. Among them were two Nobel laureates, Sir V.S. Naipaul (literature) and Amartya Sen (economics). Sir Anerood Jugnauth, prime minister of Mauritius, was there, along with numerous executives from western countries. "Welcome home," said India's prime minister, Atal Behari Vajpayee.

While countries such as China, Israel and Ireland have habitually welcomed their diasporas, NRIs used to be dubbed "not required Indians". Some were regarded as too poor to be bothered with. Those who joined the brain drain of talent to the United States and elsewhere were resented for their success.

Such attitudes began to change in the mid-1990s when India started to open up its economy and establish itself as a leading software producer, just as NRIs were emerging as software tycoons abroad. The government's interest remains basically economic, hoping that NRIs will invest in India, and work to improve India's reputation in their adopted countries. "The overseas Indian matters to the mother country only as a cow that can be milked matters to its owner," says Lord Parekh, a Gujarat-born professor at the London School of Economics. Progress to milk the diaspora has so far been slow. Whereas overseas Chinese have contributed as much as 70% of China's foreign direct investment over the past 15 years, NRIs have provided less than 10% of a far smaller total for India.

Mr Vajpayee may feel his interest in the diaspora could be of benefit to the ruling Bharatiya Janata Party (BJP), with its ties to Hindu nationalism. Lord Parekh reckons that most diasporas tend to be more right-wing than their counterparts at home, which fits in with the party's desire to use the NRIs to help "mobilise patriotism" (as well as contribute to its election expenses). That is worrying, given the violence in Gujarat last year. Those clashes were encouraged by the Vishwa Hindu Parishad, an extreme Hindu-nationalist organisation closely associated with the BJP, and which gets money from Indians in America and Britain.

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Iraq, the UN and America

The contradictions of a crisis

Jan 23rd 2003 | CAIRO
From The Economist print edition

AP

A man from Mars might detect a peaceful conclusion. He'd probably be wrong

Get article background

AS THE January 27th deadline for a report by the UN's inspectors on Iraqi disarmament nears, is war growing more or less likely? The answer, impossibly, appears to be both.

When the Security Council gave Iraq a last chance to rid itself of alleged stocks of noxious weapons last November, and gave inspectors new powers, the decision was unanimous. That show of unity, backed by the threat of American force, prompted Iraq to allow its prickly sovereignty to be trampled in unprecedented fashion. Saddam Hussein looked weaker than ever. But as the inspections progress smoothly, if inconclusively, and as America piles on pressure remorselessly, the unity among Mr Hussein's foes is eroding faster than is his own grip on power.

George Bush, ratcheting up the warlike rhetoric this week, likened Iraq's supposedly sneaky behaviour to “a re-run of a bad movie”. The alternatives to force, insisted several of the president's lieutenants, were just about exhausted. Against this, several things are happening: three of the Security Council's five veto-wielding members say they disagree with America's assessment; the weapons inspectors praise Iraqi co-operation (though demanding more); the largest anti-war demos since Vietnam have taken place worldwide; oil prices have risen and Mr Bush's ratings are drooping. The movie re-run, perhaps, is not so much about an outlaw cornered in a gulch, as about the posse abandoning the sheriff and heading on home.

The posse still looks formidable, however. America's own military build-up, set to reach 150,000 troops and four aircraft-carriers in the next few weeks, has been bolstered by the dispatch of substantial British and Australian forces. Local allies such as Saudi Arabia, Jordan and Egypt have been cajoled into offering useful, if discreet, access to their facilities. Crucially, Turkey, another recalcitrant ally, has agreed in principle to the stationing of perhaps 15,000 American troops on its southern border, presenting Iraq with the grim challenge of a two-front invasion.

An American-inspired propaganda offensive has also built up steam. Rumours, fanned by American-financed Iraqi opposition groups, speak of Saddam loyalists smuggling gold and their children out of the country, and of the dictator preparing a special aircraft in which to flee. Iraqi officials receive e-mails recommending surrender or punishment. More than 1m air-dropped leaflets litter Iraq: “How many more

soldiers is he willing to sacrifice? Will your unit be next?", they demand.

Further cheer to America's war party will come from the likely failure of belated efforts by some of Mr Hussein's neighbours to throw him a lifeline. Foreign ministers from Turkey, Iran, Egypt, Jordan, Syria and Saudi Arabia got together in Istanbul on January 23rd, largely in response to massive popular pressure in all six Muslim states to do something to avert a conflict that most in the region see as a cynical American power grab.

But what that "something" might be is not clear. Ideas of coaxing Mr Hussein into exile, for example, are generally pooh-poohed as a fantasy. More probably, Iraq's neighbours will placate America by reasserting Iraq's need to bow to UN demands, and placate their own public opinion by insisting that any American action must have explicit Security Council approval.

The Bush administration, backed with slightly less enthusiasm by Britain, asserts that since Iraq is already in "material breach" of UN resolutions, no further permission is needed. But virtually everyone else begs to differ, including the American public, 58% of whom said in a recent poll that they need more evidence of Iraqi misdeeds to justify war (see article).

Is such evidence likely to appear soon? The tireless weapons-inspection chiefs, Hans Blix and Muhammad El-Baradei, hinted otherwise after talks in Baghdad last week. Due to report to the Security Council on Iraqi compliance on January 27th, they are unlikely either to give a clean bill of health or to condemn Mr Hussein outright. Instead, they will ask for more time to complete their mission. Given the unequivocal statements opposing hasty action coming from China, Russia, France, Germany and others, this is what they are likely to be granted.

Will America and Britain go to war anyway? Probably not, at least right away. Aside from the inadvisability of flouting world opinion, their military deployments will not be complete until mid-February at the earliest. Meanwhile, after 60 days on the ground, the weapons inspectors have only now reached full operating strength. They are already producing a steady trickle of interesting facts, and Iraq has promised them fuller co-operation.

Still, given the scale and cost of America's deployments, the political capital Mr Bush has invested, and the rest of the world's inability to do much more than hold up a yellow card, it looks unlikely that Mr Hussein will escape from this latest fix. In the end, world opinion is not quite as disunited as it appears. Few outside America relish the idea of watching a wounded country being mauled by a superpower, but just about everyone would like to see Iraq's dictator depart.

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Israel's election

Voting for fuzzy unity

Jan 23rd 2003 | JERUSALEM
From The Economist print edition

Israelis see something in Ariel Sharon that eludes most outsiders

AP

Mitzna's too honest for his own good

ELECTIONS in Israel are never over when they're over. Because of the proportional-representation system, the multiplicity of parties and the low threshold, nobody ever wins a majority. And so the voting is followed by weeks, sometimes months, of coalition-making, conducted with all the candour of a poker game.

This year's post-election dealings may be even more wearying than usual. Ariel Sharon's front-running Likud party is likely to emerge from next Tuesday's vote with barely a quarter of the 120 seats in the Knesset. The next-largest party, Labour, will probably scrape only 20 or so.

Mr Sharon could probably cobble together a majority if he woos and wins the far-right National Union Party, together with the three Orthodox parties and several smaller factions. He says, however, that he does not want his hands tied by parties even more hardline than his own. He wants to reconstitute the “national unity” alliance he had with Labour for much of the past two years. But Labour, under its new leader, Amram Mitzna, has pledged not to serve under Mr Sharon. The predicted impasse goes to the guts of the Sharon enigma. His aides say the 74-year-old ex-general wants to conduct his next term as a statesman and peacemaker, eyeing his place in the history books.

Does this mean he intends to make a fair offer to the Palestinians, abandoning the Bantustan-like formula he has, until now, proposed to force down their throats? And if they reject him, would he embrace Mr Mitzna's plan for unilateral withdrawal and physical separation from the Palestinian territories? There are many in Labour who need the merest whiff of such heady speculation in order to brush aside Mr Mitzna and his solemn pledge, and plunge back into the fuzzy warmth of a unity coalition under Mr Sharon.

Another enigma: how can Mr Sharon be winning this election with the *intifada* raging, the economy in crisis, and many Israelis saying they have never had it so bad? The same polls that put him in the lead show a majority of the public spurning his neo-colonialist peace policy and preferring Mr Mitzna's ideas.

The Likud, moreover, has been wallowing in sleaze during the campaign, some of it lapping at the Sharon family itself. The sleaze stories did hurt the Likud, but they hurt Labour too. People reading of rot in one veteran party instinctively extrapolated to the other. The result: narrow-issue parties such as Shas (Orthodox) and Shinui (anti-Orthodox) appear to have picked up the disaffected Likud voters.

On peace policy, the central issue in this election, the neophyte Mr Mitzna may have muddied his unilateralist message by insisting that he would try to negotiate with the Palestinians first, and order a unilateral pullback only if the Palestinians refused to talk. He declined, moreover, to rule out Yasser Arafat as his negotiating partner. That is a sure-fire vote-loser in the current Israeli climate, and the Likud has made the most of it.

Mr Mitzna admits he is too honest for his own political good. But he says he believes in telling it as it is. Mr Arafat's signature, like nothing else, could make an agreement stick. He blames his indifferent showing on his national unfamiliarity—he is mayor of the northern town of Haifa—and also on the historic but abiding hatred for Labour among many of the Sephardic or oriental Israelis.

He can blame only himself for his declaration last week that Labour would never sit at Mr Sharon's cabinet table. He forced his senior party colleagues to mouth the commitment, too. But some of them whispered to journalists that they did not mean it. Some said they would join the government, if invited. Others even suggested dumping Mr Mitzna before the election, and installing the indefatigable Shimon Peres, now 79, in his place. A poll in *Maariv* on January 20th claimed Mr Peres's candidacy would bring in ten more seats for Labour, giving Likud and Labour together almost 60. An exaggeration, perhaps. But the figures did seem to reflect a widespread desire to return to the unity partnership, personified by these two old personal friends and political rivals.

On a deeper level, the yearning for unity expresses an enduring Israeli consensus that the collapse of the peace process, and the violence that ensued, were not of Israel's making but due to Mr Arafat's obduracy. Mr Sharon's broad support still rests on that perception. The old soldier has been doing his best, people say resignedly. His best has been demonstrably inadequate, most agree. But, with a war about to erupt nearby and Israelis feeling more threatened than ever, they seem not disposed to ditch him.

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Tehran's municipal politics

Dishing the dirt

Jan 23rd 2003 | TEHRAN
From The Economist print edition

Will sacking the mayor and council make the city cleaner?

A TROUBLED city of 7m people, filthy air and anarchic traffic, Tehran has now lost its council and its mayor. Last week, a supervisory body dissolved the council that had been chosen in 1999 at Iran's first municipal elections. This week, the government sacked Muhammad-Hassan Malek-Madani, the mayor whom the council elected ten months ago. He is reported to have been sentenced to five months in prison. New municipal elections are due to be held throughout Iran at the end of next month.

At one time, Tehran's council had boasted two national figures, but national politics did for both. One was jailed for being on the reformist side of the reformist-conservative divide, and the other was incapacitated by an assassin's bullet. Without the disciplining presence of the two heavyweights, contumacious councillors busied themselves with procedural obstruction and shouting “corruption” at each other; in all the excitement, they neglected the trifle of passing a budget for the current Iranian year, which has only three months to run.

Ebrahim Asgharzadeh, Mr Malek-Madani's bête noir on the council, accused the ex-mayor of being spurred by his developer pals, rather than by his stated concern for Tehran's overburdened infrastructure, when he restricted the sale of building permits last spring. House prices in posh north Tehran, where the developers had sunk money, soared. Muhammad Atriafar, the former council's leader, flung Mr Asgharzadeh's charges back in his face. He depicted him as the cat's paw of some 500 builders who, he said, had turned over billions of dollars during the 33 months of frenzied activity that preceded the restrictions. Neither side, however, wants to take the other to law.

Tehranis looked on, with distaste. Infrastructure contracts are said to have been bought, not won, and minor engineering work can take ages—the better, say informed residents, to win loot for favoured contractors. The armed forces have ignored demands to pay taxes on the commercial properties they built. And the limited construction work that did take place during Mr Malek-Madani's tenure was not distinguished by much respect for earthquake regulations.

The government encouraged Tehran to be self-sufficient, and the sale of building permits helped it to become so. As a generator of cash, the city attracted much political attention: Muhammad Khatami's 1997 election as president was in part bankrolled by the “technocrats” who were then running the city. Ali Akbar Hashemi Rafsanjani, the godfather of the technocrats (and an ex-president), is now planning a national comeback. If his supporters win control of the council next month, another technocrat will no doubt occupy Mr Malek-Madani's vacant seat.

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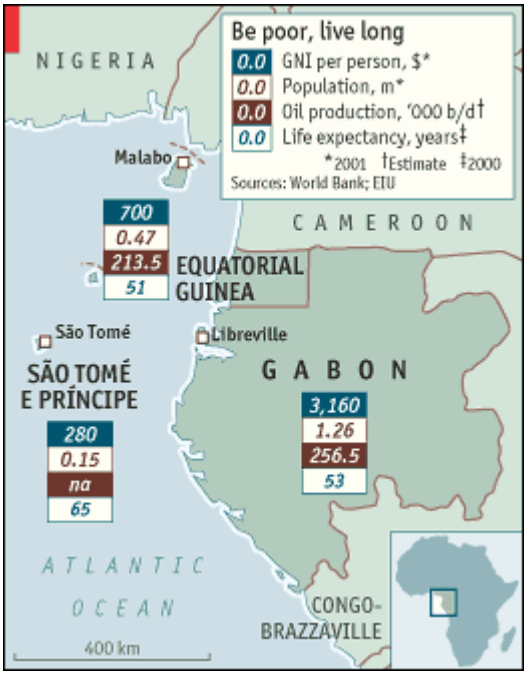
São Tomé and its neighbours

What oil can do to tiny states

Jan 23rd 2003 | LIBREVILLE, MALABO, SãO TOMé
From The Economist print edition

São Tomé is about to strike oil. Bad luck, perhaps



MAROONED off Africa's western coast, the 150,000 people of São Tomé e Príncipe scrape a living from cocoa, fish, aid and tourism. But oil firms, sniffing with seismic ships, think billions of barrels may lie beneath the island-state's territorial waters. Oil could change everything in this former Portuguese colony. This week, for instance, the president, Fradique de Menezes, sacked a parliament that had been planning to curb some of his powers—including his power to negotiate oil deals. An election will be held in April.

“People are not ready [for oil]. It could be dangerous,” says Guilherme Posser da Costa, a former prime minister. A look at two of São Tomé's neighbours, who are both small and oil-rich, suggests he is right to fret. In Equatorial Guinea, a former Spanish cocoa colony, and Gabon, a French-dominated oil emirate, oil has done little to ease poverty or lengthen life, and much to corrupt politics.

Equatorial Guinea now pumps more oil per person than Saudi Arabia. Its economy, once negligible, has grown at an incredible 40% annually since 1996, when the boom began. A few years ago, the streets of the capital, Malabo, were as quiet as São Tomé's are today. Now, Malabo's pretty Spanish colonial architecture bristles with satellite dishes, and the streets, bathed at night in an orange glow from gas flared at a nearby methanol plant, are gaudy with sports cars, tropical palaces and prostitutes who flutter in from nearby countries such as Cameroon. And the tiny country's agriculture is blighted: cocoa and snail farmers have rushed to the towns to grab a slice of the oil bonanza.

Equatorial Guinea was never well-governed: Obiang Nguema, the president, seized power by executing his uncle in 1979. But oil has made his regime increasingly paranoid. Several members of the ruling family are thought to want a bigger slurp at the oil barrel. Mr Obiang sees plots everywhere, and arranges periodic crackdowns. Several opposition leaders were jailed last year after a mass trial, to which many defendants turned up with broken arms and legs. Mr Obiang scoffs at western notions of transparency, insisting that how much money his government earns from oil is nobody else's business. “Oil has turned him crazy,” says Celestino Bacale, a brave opposition politician.

In next-door Gabon, Omar Bongo has been in power since 1967. He is more subtle than Mr Obiang. He does not torture his enemies but buys them off. Decades of oil revenues have corrupted Gabonese society and eroded the work ethic. Citizens aspire to soft billets in the civil service, and turn their noses up at menial jobs like taxi driving or shopkeeping, which they leave to immigrants from poorer places such as Togo and Mali. Agriculture in Gabon, as in Equatorial Guinea, is all but dead.

The elite in Libreville, Gabon's capital, buy French bottled water, French milk and *rognons de volaille* gourmet catfood. Mr Bongo helps French companies keep competitors out, and France thanks him by stationing 600 soldiers next to one of his palaces, and neglecting to criticise him when he wins rigged elections.

Sadly for Gabon's petrocrats, however, the oil is running out. As output falls, the civil service may no longer be able to pay all its thumb-twiddlers, the migrant workers may go back home, and the Gabonese

may have to relearn how to grow cocoa and drive taxis. And Mr Bongo may no longer have the funds to buy off his opponents. Recently, he has been stuffing the army with people from his home region.

Will oil bring similar troubles to São Tomé? Perhaps not. Independent-minded voters booted out the incumbents in two of the last three presidential elections. Mr de Menezes, a cocoa farmer who was elected in 2001, is trying to wriggle out of the oil-exploration contracts that his predecessor signed with Nigerian, American and Norwegian companies, and which the IMF agrees were bad deals.

This is holding up exploration along the maritime border with Nigeria, which the two countries plan to develop together. The president says that “oil interests” are trying to destabilise him. He also fears Nigeria, which has 800 times the population and a big army. So he has been making friends with America, breakfasting with George Bush in New York last year, and playing host to American military advisers. If oil is found, it will not flow for several years. But when it does, it could shake up São Tomé like a firehose aimed at a handful of sand.

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Franco-German relations

Spectacle or substance?

Jan 23rd 2003 | PARIS
From The Economist print edition

EPA

It is unclear whether this week's grandiose reaffirmation of friendship in Versailles between France and Germany will lead to a genuinely new relationship

AS AN exercise in pomp and protocol, the declaration of renewed Franco-German friendship will be hard to beat. On January 22nd, President Jacques Chirac and Chancellor Gerhard Schröder met at the Elysée Palace to pledge their nations' faith in a shared future. Some 603 German MPs had been invited to join 577 French counterparts in a special congress in the palace of Versailles. The next day the theme was the same but the location had changed: Mr Chirac was in Berlin, making two speeches of suitable gravity and opening a new French embassy—"our best, most beautiful and most expensive," he joked before the event.

Yet, 40 years after Charles de Gaulle and Konrad Adenauer signed the Elysée treaty, do the protestations of mutual affection in this week's "Elysée Declaration" add up to genuine love? It is easy to argue that France, with its Gaullist tradition, will never be ready to subordinate its own interests for a notional common good.

For example, in Brussels, on the eve of the declaration, France's finance minister was blithely threatening to defy the constraints of the European Union's pact on stability and growth, a package of economic disciplines put in place in 1997 at Germany's insistence. The day before, at the United Nations in New York, France's foreign minister, implying a willingness to use his veto in the Security Council, was laying down a diplomatic gauntlet: if the United States took "the military short-cut" against Iraq without a new council resolution, France would "assume its responsibilities right to the end".

Though Mr Schröder in last autumn's re-election campaign said that Germany would take no part in any war against Iraq, such independence of thought and word is a German exception, whereas for France it is almost a rule. Indeed, the German foreign minister, Joschka Fischer, conceding that "it would be entirely wrong to place us in the same rank with France and Britain on foreign and security policy," commented this week that the Germans "are still discussing who we are—a question that appears absurd to any French person."

In that case, does this week's declaration amount to anything more than an empty wish-list, to be ignored when the going gets tough? Helmut Schmidt, who as Germany's chancellor in the 1970s and early 1980s enjoyed a Europe-minded friendship with France's President Valéry Giscard d'Estaing, is one public doubter. In an interview with *Le Monde* this week, he declared that the "Franco-German motor of Europe no longer exists...What we need is a new treaty for a larger Europe, not a new one for France and Germany."

Possibly so. But as a pundit for Arte, a publicly-funded Franco-German television channel founded in 1991, comments, the wish-list “creates obligations”. Some, for sure, will be more easily met than others. By all means declare January 22nd “Franco-German day”. Similarly, do put more cash into the Franco-German University (a network linking students in both countries), or insist that two foreign languages are taught at school. Such measures may or may not reduce the dominance of English (fewer than 1m French secondary-school pupils now learn German and only 5% of Germany's schoolchildren are still studying French in their final year), but their virtue is that they are hard to quarrel with. More tantalising, perhaps, is a proposal that French and German citizens may, if they wish, take dual nationality.

A share in everything?

The harder obligations are those that go to the heart of government policy. Messrs Chirac and Schröder have bravely committed themselves not just to maintaining, and even accelerating, their rhythm of special meetings every six weeks. They have also decided to appoint in each other's country “a secretary-general for Franco-German co-operation”: a suitable Frenchman “of high level” will be attached to the chancellery in Berlin and a German counterpart will be posted to the office of France's prime minister, currently Jean-Pierre Raffarin, in Paris. Each, it seems, “will co-ordinate the preparation, implementation and follow-up” of the two nations' common European policies.

Nor does co-operation end there. When one country's cabinet discusses a subject of concern to the other, it will be joined by the relevant minister from that country, and “common Franco-German legislation” will be proposed to respective parliaments that will share both ideas and personnel and exchange regular visits by their European-affairs committees.

Dream just a little and the idea of a Franco-German Union, advocated this week by Pascal Lamy and Günter Verheugen, respectively French and German members of the European Commission, does not seem entirely outrageous. After all, this week's declaration already talks of the two countries taking co-ordinated or common positions when the EU talks of foreign policy, defence or the economy.

In the meantime, will reality spoil the dream? At this week's joint press conference at the Elysée, it was Mr Chirac who dominated, especially on Iraq. But that reflects reality. France, after all, is a nuclear power with its permanent seat in the Security Council, while Germany is militarily puny and diplomatically still nervous.

Given the strains of domestic politics and the poor empathy between president and chancellor, there will be plenty of sceptics to agree with Mr Schmidt. But there is a more generous interpretation: that France and Germany, like an old married couple, have many interests in common and can agree to disagree on the others. In the words of Hubert Védrine, France's foreign minister until the left lost last year's general election, “the Franco-German motor is still necessary but no longer sufficient” for reshaping Europe.

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French restaurants

Better value, lower tax?

Jan 23rd 2003 | PARIS
From The Economist print edition

The government says it can make bistros cheaper and better

WHAT heaven! *Coquilles Saint-Jacques* to start, then perhaps a *magret de canard*, a morsel of goat's cheese, and finally a cholesterol-boosting *crème brûlée*, all washed down with a modest glass or two from Châteauneuf du Pape. So why should government bean-counters spoil this brief excursion into paradise (well, two hours, to be civilised) by slapping a value-added tax of 19.6% on the bill?

The obvious answer is to raise money, but France's 140,000 restaurant-owners are fighting back. Why, they ask, should take-away food have a VAT charge of just 5.5%? Is the government trying to force *la malbouffe* of junk-food hamburgers on to a hungry nation? Does the government want to force the restaurateurs, with their 500,000 employees, out of business?

Presumably not. During his re-election campaign last year, President Jacques Chirac, a man with a healthy appetite for both food and votes, gave a half-promise to lower the restaurant tax. The problem is how. Since VAT rates in the European Union are meant to be in reasonable harmony (in Denmark, for example, the rate for restaurants is 25%; in Belgium 21%; and in Germany 16%), any change to France's VAT rate would need France's partners to approve.

Yet there is an encouraging precedent. Arguing that a lower value-added tax on home-improvements would create employment and lessen tax evasion, France three years ago secured a “temporary” rate of 5.5% for house renovation and other home-improvements. Hence a pledge this week from a lobby-group of big restaurant-owners: if the VAT rate is lowered, they will cut their prices by 5% and raise the salaries of their waiters and washers-up by 10%, creating in the process a virtuous circle that should—they say—increase their clientele by 14%, employment by 40,000 and the number of restaurants by 20,000.

All of which will give the European Commission, now examining a memorandum from France's government, something to chew on before it issues a report on VAT in March, in time for a decision by the EU's belt-tightening ministers of finance in June.

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Germany's state elections

More misery for the chancellor

Jan 23rd 2003 | HANOVER
From The Economist print edition

The ruling Social Democrats are likely to do dismally in coming state elections

THERE was a time when Sigmar Gabriel, pugnacious Social Democratic premier of Lower Saxony, one of Germany's 16 *Länder* (states), delighted in his nickname of "little Schröder". It marked him out not only as the former protégé of his illustrious predecessor as state governor but also as a potential successor to Gerhard Schröder as his party's national leader and even as Germany's chancellor.

No longer. These days, any association with the beleaguered chancellor is more of a handicap than a bonus. In the run-up to next week's elections in the state, Mr Gabriel has been visibly keeping his distance from his old mentor. In any event, the odds against Lower Saxony's bouncy young leader keeping his job look long. The latest polls give the opposition Christian Democrats, led by decent but lacklustre Christian Wulff, a nine-point lead—quite a turnaround from Lower Saxony's last state election, in 1998, when the Social Democrats, then led by Mr Schröder, won by 12 points.

That is not primarily Mr Gabriel's fault. Despite failing dismally to keep his pledge to balance the debt-ridden state's books, he has been a dynamic premier, investing heavily in education, law and order, and jobs for the young—the campaign's three top issues. In September his party still had a ten-point lead; he was expected to romp home to a second term.

But the tide has turned so heavily against the Social Democrats in the country as a whole that these days few of the party's state leaders would be able to fend off an election challenge from the conservatives. Almost as soon as Mr Schröder's federal government won re-election in the autumn, it began to flounder.

The economy now looks grimmer than ever: it grew by a miserable 0.2% last year, its slowest in nearly a decade, with little pick-up expected this year. Meanwhile taxes and welfare contributions, which Mr Schröder had promised to hold steady, have shot up. Unemployment, now at 4.2m, continues to rise. Germany's crisis over health care and pensions is worsening. Recent ministerial talk of necessarily painful reform has rattled voters still more.

Confidence in the government has plummeted. Some 80% of Germans now disapprove of its policies; two-thirds accuse it of breaking its election promises. Pollsters put the Christian Democrats around 17 points in the lead, nationwide. As Mr Schröder struggles to fend off unsubstantiated rumours, gleefully reported by British tabloids, that his five-year-old marriage to his fourth wife, Doris, is in trouble, his own popularity is tumbling. Some of his adversaries now predict that a defeat for the Social Democrats in his home state could help finish him off.

In the other *Land* election on February 2nd, in neighbouring Hesse, the ruling Christian Democrats, led by Roland Koch, a party heavyweight who has been tipped as a possible future chancellor-candidate, seem bound to win again—and handsomely. As in Lower Saxony, the economy, jobs, education and crime have dominated the campaign. A long-planned extension of Frankfurt's airport was another big issue, especially as the Greens, who would probably be part of any government in Hesse led by the Social Democrats, are vehemently against the idea.

If the conservatives do win, Mr Schröder will find it even harder to push controversial legislation through the Bundesrat, parliament's upper chamber, where the states are represented and where the conservatives already hold an absolute majority of votes.

Might that prompt the collapse of Germany's government or the resignation of Mr Schröder, as his opponents hope? Unlikely. Mr Schröder has looked rocky before. After a string of state-election losses in the autumn of 1999, his downfall was widely predicted. Do not bet on him bowing out in a hurry.

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The Netherlands' election

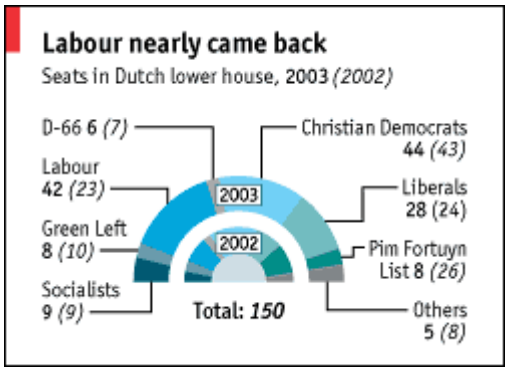
Sighs of relief

Jan 23rd 2003
From The Economist print edition

The Christian Democrats hold on to win—but only just, after a scare

POLLS put them neck and neck, as the Dutch went to vote on January 22nd. In the end, Jan Peter Balkenende's Christian Democrats narrowly beat off Labour's late run, with 44 seats to 42, out of 150. Now for the harder part. From election to the habitual Dutch coalition is often a weary process. This time too, probably.

Not even in the campaign did the main parties differ widely, even counting in the third-placed free-market Liberals. Still less would the imaginable coalitions. Yet this was a true political event, unforeseen in October, when the then government—Mr Balkenende and party, with the Liberals and the populist Fortuynists—fell apart; the Dutch are in a new political landscape.



The big surprise, for all that the party came only second, has been the rebirth of Labour. After eight years running a coalition, it and its new (and, as it turned out, interim) leader were humiliated last May: Labour slumped from 45 seats to 23. Yet under a further new leader, telegenic Wouter Bos, it shot up during the latest campaign; indeed the three main opinion polls in the closing days put Labour ahead.

But this is not the same old Labour Party. For that, thank last May's big gainers, the brand-new Pim Fortuyn List, built round hostility to immigrants, distrust of the unlistening elite, the personality of its leader and little else. His murder just before voting day may even have helped it to its 26 seats then. But the longer-term effects were deadly. The party fell apart, and this time its vote collapsed.

Even so, less than polls predicted. And the campaign proved Fortuynism far from dead. Out went the cosiness of the elite: Mr Bos went out of his way to lend his ears to the voters. Out went political correctness. And into all three main parties' view of immigration, openly, came much of what Fortuyn and the voters had said.

EPA

Balkenende, delighted to scrape home

The coalition choices before Mr Balkenende, planning his second term, are not easy. Link up with Labour? This would be no novelty, but not to his taste. And agreeing on policy would be hard: on issues such as health and education Labour went left during the campaign. A rerun with the Liberals? Mr Balkenende fancies that, but he would need a third party, again risking the instability that he is eager to avoid.

Labour meanwhile, though happy with its revival, is lamenting “so near and yet so far”. Its only real choice, had it come first, would have been a coalition with the Christian Democrats. But it would have had first crack at the prime ministership. It may regret a constitutional near-novelty proposed by Mr Bos. He wanted to lead Labour from parliament, not quit his seat (as the constitution requires) to become prime minister. His candidate for that job, named only last weekend? Job Cohen, the excellent mayor of Amsterdam—but no figure in the campaign and elected by no one.

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Portugal and Spain

Those big boys next door

Jan 23rd 2003 | LISBON
From The Economist print edition

Some people in Portugal think Spanish firms have too much influence there

ANDALUSIA, Catalonia, Galicia...Portugal? It could have happened: a more handsome Portuguese suitor for the hand of a certain Castilian princess, or a less distracted king in Madrid, some historians argue, are all it would have taken for Portugal to have been part of Spain for the past four or five centuries. A Spanish historian has just produced evidence that the grandfather of Spain's present King Juan Carlos, King Alfonso XIII, was contemplating the annexation of Portugal as recently as the early 20th century.

News like this still causes frissons in Portugal. The country's history can be summarised as a struggle not to be absorbed by its far larger neighbour, and its citizens remain conscious of the issue. Even now, they mark the anniversary of a 17th-century revolt that ended the only period, 60 years, of Spanish rule. And Portugal still does not recognise Spanish ownership of a stretch of land that the Spaniards seized during the Napoleonic wars and in 1817 agreed to give back—but didn't.

Yet surely there is no real cause for Portuguese concern today? Both countries emerged from decades of dictatorship in the 1970s. They are democracies, allies in NATO, partners in the European Union. That is exactly the trouble, say the 40 Portuguese economists and business leaders who in a recent open letter gave warning of the danger of Portugal's decision-making centres moving abroad.

“Throughout history,” says Vitor Bento, one of the 40, “Portugal has managed to remain free from Spanish influence by belonging to different international alliances. This is the first time we have been part of the same ones. People tend to see national sovereignty from a narrow, political point of view. We are trying to point out that in an era of market globalisation, the economy too is vital to a country's autonomy.” As well as the direct loss of jobs, power and wealth, he says, universities, research units, banks, consultancies and other services are all weakened when big corporations that they work with are taken over and their headquarters moved abroad.

The “patriots' manifesto” made no specific mention of Spain. But foreign influence in the economy is really an issue only when the influence is Spanish. As Carlos Tavares, the economy minister, puts it, there are two types of foreign takeover in Portugal: acquisitions by Spanish companies, which lead to magazine headlines such as “Portugal, capital Madrid”, and the rest, which rarely cause any fuss.

Since both countries joined the EU in 1986, Spain has made its presence felt. Some 2,500 Spanish companies operate in Portugal, against 300-odd Portuguese ones in Spain. Spanish banks control about one-sixth of its banking—with recent help, be it said, from one of the “40 patriots” who was instrumental in the sale of one small bank to Spain's Banco Popular.

What, if anything, is to be done? The patriotic 40 say they oppose protectionism (even if it were legal) but also that Portugal should not be so naive as to play strictly by rules that other countries bend. And they urge local firms to assert their independence by being competitive, efficient and reliant for success on the prowess of Portuguese management. And why not take a nibble at the Spanish market too?

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Russia and the Middle East

Walking on a tightrope

Jan 23rd 2003 | MOSCOW AND JERUSALEM
From The Economist print edition

Russia is not so much leaning towards the Arab world as desperately trying to keep its balance

ANYONE watching Russia's recent Middle East diplomacy might conclude that it is trying to recapture the golden age of Soviet-Arab friendship. This month Syria's vice-president was in Moscow to talk about "closer relations", with hasty denials that Russia plans to help Syria build a nuclear reactor—as it is doing in Iran, with several more planned. Meanwhile Iraq said yes to deals with three Russian oil companies, including a previously cancelled project for Lukoil, Russia's second-biggest oil company, to develop the huge West Qurna-2 field. And Russian officials went to Saudi Arabia, huddling with OPEC to agree on oil output levels that will ensure a nice price for all.

And that is just one month's work. Last year, says Mikhail Bogdanov, head of the foreign ministry's Middle East and North Africa division, was choc-a-bloc with Arab state visits and co-operation agreements. Russia, he insists, never distanced itself from the Arab world.

All this may unnerve some of Russia's newer western allies. The Bushehr reactor project in Iran is "not only a danger to the region, but to Russia's own long-term interests," said the American ambassador to Moscow, Alexander Vershbow, recently. But such frenetic Russian diplomacy in the Muslim world is really little more than a veil for the fact that Russia is now far closer to another Middle Eastern country: Israel.

This was partly inevitable. Even in the old days, Syria, Iraq and Libya were the only big buyers of Soviet arms, and those sales have dwindled. With the cold war's end, Russia's strategic need to be close to the Arab states evaporated too. "Russia doesn't have enough money to finance significant projects in the Middle East, no big economic interests except for the oil companies in Iraq, no military clout anymore, and it's still seen as treacherous by many Arab regimes because they think Mikhail Gorbachev and Boris Yeltsin [Russia's former presidents] unjustly abandoned them," says Konstantin Eggert, editor of the BBC's Russian service in Moscow and a former military translator. Talk of multi-billion-dollar projects—four years ago it was an arms deal with Syria, last year it was huge investments in Iraq—tend to dissolve into thin desert air.

These days Russia and Israel have much more in common. Both their governments are increasingly fed up with west European criticism of how they handle their respective conflicts in Chechnya and Palestine. Russians, says Yuri Shtern, chairman of the far-right Israel Beiteinu party and himself an immigrant from Russia, don't boycott Israeli products; Russian pop singers don't stay away from Israel in solidarity with the Palestinians. He thinks that Russia, already a member of the peacemaking quartet that includes the United States, the European Union and the UN, could become a closer ally of Israel.

Quid pro quo, Israel's leaders help Russia smooth over its differences with America, even those that ought to disturb Israel just as much. "Ariel Sharon has been an important asset in winning over the US on a number of foreign-policy issues, like blunting US criticism of Russia," says Vladimir Frolov, the deputy staff director of the Russian parliament's foreign-affairs committee. Israel takes care not to criticise publicly Russia's repression in Chechnya, and the two countries' special forces swap experience and training. Thanks to the Chechen conflict, with its increasingly radical-Islamic undertone, Russians have a growing distrust of Islam and sympathy for Israel, especially after the bloody events last year, when Chechen rebels took hundreds of hostages in a Moscow theatre in October and suicide-bombers blew up Russia's administrative headquarters in Chechnya in December, each incident leaving more than 100 dead.

Even on oil, Russia circumvents the Arab world when it has to. It may be cosy with OPEC now, but a year ago it was quietly breaking agreed production limits. And a plan to start pumping Russian oil this year

through a disused Israeli pipeline from the Mediterranean to the Red Sea would both ensure Israel's oil supply and help Russia break the Arab states' near-monopoly on selling oil to Asia.

Russian-Israeli connections reach into domestic affairs too. Israeli politicians go to Moscow at election time to woo Russian television stations, which still reach the 15% of Israelis who immigrated from the former Soviet Union. Amram Mitzna, Labour's candidate for prime minister in Israel's upcoming election, would have a better chance were it not for his almost total lack of support among Russian-Israelis. Russia's politicians, for their part, now cultivate ties with Jews at home; some are powerful in business. The anti-Semitism that infected Soviet thinking is now, says Evgeny Satanovsky, head of the Russian Jewish Congress, “the last in a long queue of other Russian xenophobias”.

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Charlemagne

Tyranny of the tiny?

Jan 23rd 2003
From The Economist print edition

The European Union's small countries should stop whining. They get a fantastic deal out of the EU

Get article background

LIFE as a small European country has not always been easy. Belgium for decades was a battlefield for its larger neighbours; Czechoslovakia was dismembered after a shabby deal between the big European countries in 1938; the Baltic states simply disappeared into the Soviet Union. Since the European Union came along, however, things have looked up. Europe's “smalls” see the EU as a guarantee that the continent will be run by law rather than force. By 2004, when the Union will take in another ten countries, small ones will predominate. Yet six “bigs”—Germany, Britain, France, Italy, Spain and Poland—will account for 74% of the population, with 19 others making up the rest of it.

As the EU contemplates how to run itself in the future, the tension between big and small countries is emerging as perhaps the Union's deepest fault line. This week it burst open at the EU's constitutional convention in Brussels, thanks to a joint proposal by France and Germany to set up a potentially powerful new post of president of the European Council, the organisation that runs the summits of EU heads of state. The Franco-German idea was heartily endorsed by Britain and Spain but swiftly denounced by the smalls. They fear that a new president of the council would concentrate on cutting deals among the bigs, and so undermine the European Commission, the EU's executive, which has traditionally protected the rights of the smalls.

No sooner had Valéry Giscard d'Estaing, the convention's president, brought down his gavel to begin the session, than the denunciations began. Gijs de Vries, the Dutch government's man, accused the bigs of undercutting the principle of “equality between all member states”; Ireland's Dick Roche spoke darkly of an “institutional coup d'état”; Teija Tiilikainen, a Finn, accused the bigs of aiming for a “system of oligarchy”. Each fierce denunciation was greeted with equally fierce applause from the convention floor.

So three cheers for Europe's plucky little minnows? Not really. First, it is not at all clear that the idea of a more permanent president of the European Council is as sinister as they seem to suppose. The present system, in which each country takes the helm for six months at a time, is a shambles. If a reformed system introduced greater continuity, it could only be for the better.

The more important point, however, is that the present EU system is already hugely stacked in favour of small countries. Take the euro: before the single currency was adopted by 12 EU countries, the European Union was, essentially, in the D-mark zone. Germany set interest rates to suit its own economy, and most other Europeans were then obliged to adapt. Now things have changed. The head of each country's central bank has an equal voice in making European monetary policy; the governor of Germany's Bundesbank, for instance, has no more say than the governor of Greece's central bank. Partly as a result, Germany is now discovering that European monetary policy is too tight for its struggling economy. Wolfgang Clement, Germany's minister for employment, recently told the *Financial Times*, a tad melodramatically, that the German economy had had to “sacrifice itself” to the goal of European integration.

The arguments within the convention hall this week that a Franco-German duopoly is threatening to dictate to the rest of Europe were simultaneously being undermined at a meeting of EU finance ministers elsewhere in Brussels. France and Germany were singled out for reprimands for their excessive budget deficits. Germany contritely promised to cut its government spending; France defiantly said it would press ahead with its spending plans but is risking a confrontation that it seems doomed to lose.

Voting in EU institutions is so heavily weighted in the smalls' favour that it borders on the anti-democratic. Whereas in the United States a bias towards small states in the Senate is balanced by a House of Representatives where votes depend on population, all three of the EU's major institutions—the commission, the parliament and the council—are heavily weighted in favour of the smalls. Once the EU embraces 25 members, every country will be entitled to one European commissioner with one vote. In theory, these commissioners will think only of the European interest, yet the ferocity with which the smalls are demanding to keep their right to a national commissioner suggests otherwise.

Small country, big vote

Representation in the European Parliament will be adjusted a little, after enlargement, to reflect countries' relative sizes. Yet even then, it will still take more than 800,000 votes to elect a German or British MEP but less than 80,000 to elect one from Luxembourg. The Council of Ministers, where national governments vote on European legislation, is similarly slanted. Even when a fiercely contested reweighting of votes is put into place in 2005, Germany with 82m people will have 29 votes, while Belgium with 10m people will have a dozen votes and Ireland with 4m will have a good seven.

The bigs accept the weighted decision-making and complex legal procedures of the “community method” when it comes to competition policy and the internal market. But Germany and France are chafing at the effects of European-wide monetary policy, and Britain is so wary of the idea that it has not even joined the euro. Now the EU is intent on expanding its role in foreign policy and defence. But, given that the bigs will provide most of the money and military muscle to enforce common foreign policies, it is hardly surprising that they are wary of being constrained by smaller countries with voting weights that do not accurately reflect their size. That is partly why the bigs like the idea of a new president of the European Council to co-ordinate foreign policy in a more informal manner. Outrageous and undemocratic, say the smalls. But, as every convention delegate likes to say, the EU is a “union of nations and peoples”—and it is an unavoidable fact that most of its people live in six nations.

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Grands projets

Why is Britain so bad at big projects?

Jan 23rd 2003
From The Economist print edition

The list of grand government-sponsored schemes that have ended in disaster or been abandoned is lengthening

WHEN Sydney, Athens and Beijing bid for the 2000, 2004 and 2008 Olympics, governments and people were united in their determination to secure this prestigious opportunity for the nation. When London thinks about putting in for the 2012 games, Treasury ministers pour cold water on the idea, privately calling it “madness”, even though 80% of Britons are keen. Politicians say that bringing the games to London could cost as much as £4.5 billion ($7.3 billion) and would overload the capital's transport system.

Supporters of a bid say such numbers grossly exaggerate the costs and take no account of the fact that the games would generate thousands of jobs. The British Olympic Association notes that the Sydney Olympics attracted £2 billion in tourist revenues. The mayor of London, Ken Livingstone, has offered to underwrite half of the cost of staging the games by imposing a tax on residents; central government would have to pay the rest.

The government will announce a decision on January 30th. It isn't just Treasury ministers who are unenthusiastic. Tessa Jowell, whose culture ministry would sponsor the bid, is said to be cool. Only if Mr Blair is keen and determined will the government go for it.

If politicians and civil servants are nervous, it is not surprising, in the light of recent experience. The list of *grands projets*, as the French call them, that have been disasters, or been abandoned, is a long one. The Millennium Dome, a fun-palace-cum-church hall, bombed, financially and artistically, at a cost to the taxpayer of £1 billion. London's successful bid to stage the World Athletics Championship in 2005 had to be abandoned because it took so long to decide whether, how and where a new national stadium should be built. The cost of upgrading the West Coast main line railway has quadrupled over four years to more than £10 billion. London's Jubilee tube line was two years late and £1.5 billion over budget.

The long-mooted high-speed railway line from London to Scotland is likely to provide another example. While the rest of Europe is racing to complete high-speed networks, the inventor of modern railways has not built any new track, apart from the Channel Tunnel rail link, for 100 years. A study by W.S. Atkins, a firm of consulting engineers, to be published next week, concludes that a high-speed line would be the best way of satisfying growing demand, even though it might cost £20 billion. But with the Strategic Rail Authority's budget being slashed by £300m this year, rail insiders say the government is no longer

talking about building a bigger, better railway.

Why does Britain find it so difficult to execute *grands projets*? One reason is that it is a small, crowded island. Property is expensive, and so turfing out home-owners to make room for new roads and railways is difficult and costly. Power over planning lies in the hands of local authorities, which look after local interests, and not those of the nation at large.

Civil service culture inevitably gets some of the blame. Marco Goldschmeid, managing director of Britain's most successful architectural partnership, headed by Lord Rogers, blames a national “obsession with arse-covering”. A report last year by the prime minister's strategy unit agreed, arguing that civil servants are reluctant to take even calculated risks because they fear being torn apart by the National Audit Office and its parliamentary back-up, the Public Accounts Committee.

An “obsession with arse-covering” keeps civil servants from thinking big

The combination of Whitehall risk-aversion and the centralisation of financial power has something to do with it, says Tony Travers, head of the Greater London Group at the London School of Economics. The Treasury's control of 97% of tax revenues in the country means that no city or region can do anything grand for itself. Without financial devolution, he says, nothing will change. “We are doomed”, he concludes gloomily, “to be a country of small-scale things like the Edinburgh Festival and Scotch whisky.”

But civil servants do their masters' bidding, by and large. If they fear the political consequences of expensive grandeur, that is because the politicians are reluctant to finance big projects. These days the government is determined that infrastructure should be financed in part by the private sector; but the scale of risk involved in big projects, and the distant time-horizon, means that the public sector also has to be involved. That tends to lead to a proliferation of committees and years of painful wrangling between the public and private sectors—as with the national stadium at Wembley—over who pays for what, and how—and unsatisfactory compromises between public and private aims. That showed up in the embarrassing low-brow worthiness of the Dome.

But there is a good reason for British governments' reluctance to shell out public money to pay for grandeur. Britain is a lowish-tax economy. And since Britons do not want to pay as much of their income to the government as the French are apparently willing to, British governments have less money for Mitterrand-style follies.

Looking around the world, this does not seem such a bad thing. America, the world's most successful economy, is not much better at big projects that involve public finance than Britain is. Some of its transport infrastructure—New York's JFK airport, for instance—is dreadful. African dictators, by contrast, tend to be dab hands at *grands projets*.

Still, Britain's reluctance to think big may have gone a little too far, especially in transport. Successive reports for the government have pinpointed bad rail and road links as one of the main reasons for Britain's poor productivity. The contrast with the rest of the world is sharpening. In ten years' time, Europe, and many emerging countries too, will be covered in high-speed railways. In Britain, there will only be the 70-mile Channel Tunnel rail link. And anyway, even if the traffic jams were vile, wouldn't it be nice to have the Olympic Games?

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Preparing for war

Walking the walk

Jan 23rd 2003
From The Economist print edition

Britain sends in the Rats

SO BRITAIN may not “miss” a war with Iraq after all. Despite its bellicose rhetoric, Tony Blair's government had not, until this week, put its money and military where the prime minister's mouth has long been. Military types have been fretting about the effect of delaying a deployment on training and morale. Most observers expected that the British commitment would be small: just enough to provide George Bush with the semblance of a coalition. In the event, the package of land forces deployed on January 20th was surprisingly beefy.

Its main components are the 7th Armoured Brigade (descended from the Desert Rats of El Alamein); the Headquarters of the 1st Armoured Division; and elements of 16 Air Assault Brigade, with its core of paratroopers: 26,000 people in all. The accompanying hardware includes 120 battle tanks and 150 armoured personnel vehicles. A naval force, including *HMS Ark Royal* (an aircraft carrier), *HMS Ocean* (a helicopter carrier) and 4,000 Royal Marine commandos and supporting personnel has already been deployed. Britain's contribution to a war would also include other navy, RAF and special forces already in the region or likely to arrive soon.

All of this amounts to no more than the sort of thing dispatched by the regular flourishes of Donald Rumsfeld's pen. Michael Clarke, of King's College, London, explains that the numbers in the British package are inflated by the separate logistical support that its diverse elements require. All the same, in British terms, this is a big commitment. Around a quarter of the British army is involved; overall, the force is slightly larger than that sent to the Gulf before the war in 1991.

The principal role of even a large British contingent will be political

America could, of course, defeat Iraq alone. The principal role of even a large British contingent will be political; if the Iraqis manage to inflict significant casualties, George Bush will be especially glad to have an ally sharing the pain. Still, the nature of the deployment gives some clues as to what British soldiers might actually do on the ground. 16 Air Assault Brigade will provide the sort of troops who might descend on northern Iraq from Turkey, assuming that the current diplomatic whirl yields Turkish co-operation. The commandos might take part in an amphibious or aerial assault on southern Iraq or in urban fighting.

All of this may never happen: as ministers have been queuing up to point out, peace may yet break out. But the deployment has some implications for the possible timing and duration of a conflict.

Phillip Mitchell, of the International Institute for Strategic Studies, estimates that the 7th Armoured Brigade won't be ready for combat for at least six weeks, though British paratroopers and commandos will be ready sooner. Some tanks and other vehicles, which struggled in the sands of Oman during a recent training exercise, have not yet been (in the jargon) “desertised”. Vast quantities of desert boots and other kit have only just been ordered. (The government has played down reports about dissatisfied soldiers buying their own kit, and concerns about the reliability of army radios and rifles.)

Because an American attack could well begin without the Rats, these considerations may reveal little about exactly when a war may start. But, given the difficulty the government will face in keeping a force of this size and composition in the Gulf indefinitely, this week's deployment suggests it is planning for a relatively early and short war. The British army's other commitments in Northern Ireland, Bosnia and Afghanistan mean that a long wait—or a long war—will carry a serious risk of military “overstretch”. Rather inconveniently, some of the paratroopers destined for the Gulf have this week been covering for striking fire-fighters.

Mr Blair has other reasons to hope that any conflict turns out to be diplomatically brief. He has evidently decided that Britain's contribution to a war should not be a token one: better Mr Bush's bulldog than his poodle, seems to be the thinking. Yet support for an Iraqi conflict among the British public is declining, despite the fishy discoveries made by UN inspectors in Iraq. And the grumbling of anti-war Labour MPS is getting louder.

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Schröder v Mail on Sunday

Sour Krauts

Jan 23rd 2003
From The Economist print edition

Germany's press laws don't apply in Britain—at least, not yet

EPA

Rogue Mail

CONTEMPTUOUS silence might have been a wiser move. By taking out an injunction in a German court against a British tabloid for publishing rumours about his private life, Germany's chancellor, Gerhard Schröder, has done nothing to squelch the story, while giving his opponents a chance to froth on one of their favourite subjects—sinister continental threats to ancient British liberties.

Two weeks ago, the *Mail on Sunday* ran an interview with Mr Schröder's ex-wife (his third) about the state of his current marriage (his fourth). She appeared to confirm rumours that it was on the rocks. It linked the chancellor to a prominent television talk-show presenter. This went far further than did the handful of German press reports, which have now been silenced by court order.

By British standards, it was pretty tame stuff. Recent treats for readers have included a salacious exposé of an alleged affair by the leader of the fireman's trade union, as well as copious and somewhat tedious details of the slightly kooky habits of the prime minister's wife.

In Germany, though, standards are different. Reporting of politicians' private lives counts as a scandalous intrusion. Mr Schröder even went to court last year to scotch rumours that his hair colour came out of a bottle. But the injunction against the *Mail on Sunday* is toothless. The paper did not sell any of the offending copies in Germany, and it does not even have a proper website from which Germans could download the story. It is not clear that anyone really expected the court ruling would be enforceable in Britain.

Undeterred, the *Mail on Sunday* joyfully responded with a two page spread, under the headline “Sorry Herr Schröder, but you don't rule Britain—at least, not yet.” It also launched a hotline, staffed by its former Berlin correspondent, for any Germans wanting to share unpublished news about their head of government's private life, and invited readers to fax a letter to the German ambassador protesting about censorship, saying that “in this country we believe the public has the right to know the truth about politicians”. The investigation is continuing and the paper hopes to have more news about Mr Schröder in this week's edition.

The row confirms each side's worst fears about the other. The Germans see in it a “distasteful and regrettable undertone”, according to an official. Rightly, they think the tabloids pander to an insatiable British appetite for anti-German stories. If the Germans complain, all the better: it proves they can't take a joke—or worse.

Despite the German lawyers' failure even to try to prevent the *Mail on Sunday* from publishing whatever it likes in Britain, the paper sees the whole business as a terrible warning of the dangers of further European integration: “As the EU expands into ever more shadowy and unstable parts of Europe, we will not see English liberties carried into Slovakia or Latvia, but Slovakian practices brought here, and Latvian judges pronouncing on our rights.”

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Anti-terrorism raid

Mosque mash

Jan 23rd 2003
From The Economist print edition

A raid on a fundamentalist hangout in north London

Reuters

Different worlds

FEW bits of London are a better advertisement for prosperous and tolerant multi-racial Britain than Finsbury Park. Crowded Greek, Kurdish, Turkish, Arab and African shops and restaurants rub shoulders with a mighty indigenous business, Arsenal football club. Cultural barriers count for little in the search for profit: the Algerian-owned Café Paradise offers birthday cakes with iced greetings in both Amharic (for Ethiopians) or Tigrigna (for Eritreans).

Another local enterprise with strong Algerian connections is doing less well. Early on Monday morning, 150 police officers broke down the door of the Finsbury Park mosque, and seized hundreds of forged identity documents and some nasty but non-lethal weapons: CS gas and a stun gun. They made seven arrests—including five Algerians.

The mosque is the headquarters of Britain's most notorious and outspoken Muslim cleric, Abu Hamza, who has praised terrorist attacks on the West. He was not arrested, but is in trouble with the authorities for, among other things, using the mosque for such political purposes that its charitable status is in question. As well as fiery sermons and other fundamentalist propaganda, the mosque's rooms were also home to a shifting population of young Muslim men, many of them of interest to the authorities.

The raid has divided Muslim opinion in Britain. Many moderate Islamic leaders detest Abu Hamza, who is seen as a loudmouth and even an impostor (he has no formal theological training). Others feel that the raid was unnecessarily heavy-handed. A neighbouring outfit in Finsbury Park, the Arab-run Muslim Welfare House, issued a statement that condemned terrorism but maintained that mosques, like all places of worship, “are sacred and should be treated as such”.

For their part, the police say they went to exceptional lengths not to offend religious sensibilities during the raid; they did not search the prayer room, and officers wore special foot coverings.

The immediate effect has been shorter tempers all round, not least in Finsbury Park. Sylvia, an immigrant from southern India who has been in Britain for 25 years, says “This is the best country in the world for immigrants. We have free speech and we are left alone. But the mosque Muslims abuse it. They hate England. What do they expect people here to feel about that?”

For their part, moderate local Algerians feel stigmatised. Some of them are boycotting the Kurdish-run Finsbury Superstore because of remarks by the owner's nephew in a television interview, in which he supposedly said that the area was being taken over by fundamentalist terrorists from Algeria. It may yet all blow over. But racial harmony is slow to grow and quick to perish.

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BAE Systems

Yo, Americans

Jan 23rd 2003
From The Economist print edition

Britain's leading defence contractor clashes with the defence minister

ANY day now the government has to decide whether to order two new aircraft carriers from BAE Systems (formerly British Aerospace) or from a French competitor, Thales. The contract could be worth up to £9 billion, including maintenance. No other rich country would contemplate placing such a big defence order with a foreign company—even one like Thales, which has 12,000 employees and a quarter of its business in Britain as a result of buying Racal, a British defence company.

But the Ministry of Defence likes competition, even from foreigners. It is also more than a little fed up with the national champion, which is years late and hundreds of millions over budget with two contracts, one for submarines and another for early-warning aircraft. This week BAE re-vamped its shipbuilding business, shedding over 1,000 jobs, perhaps to persuade the government it was getting on top of things. Unless the government caves in, BAE will have to include a provision of around £1 billion in its accounts next month to cover the cost over-run. Such special charges have become a regular feature of BAE's accounts. The company's shares are at their lowest for years, depressed by the stream of bad news.

The sudden departure of BAE's previous chief executive was attributed to his poor relations with his biggest customer, as he campaigned for the government to share the risk on big contracts. But his successor, Mike Turner, seems to have done no better. Last week the defence secretary, Geoff Hoon, told American journalists that the firm was no longer British.

Although the company's base and its board are firmly British, and the government has the power to veto foreign shareholders, Mr Hoon was right in that a majority of its shareholders are American. BAE is also well-established in the United States, supplying the big defence contractors, and its chairman used to boast that it sold more to the Pentagon than to the British defence ministry, though in recent months he has been wrapping himself ostentatiously in the Union flag. BAE also has close links to American companies such as Lockheed Martin and Boeing. Were the government to lift its veto, it might even merge with Boeing one day.

Defence companies everywhere have awkward relations with their governments, but Britain's defence companies do not get the cushy ride others enjoy. Margaret Thatcher opened up defence contracts to competition in an effort to get better value for money. The abolition of cost-plus contracts has forced companies such as BAE to take huge risks on gigantic projects involving difficult technology. That's particularly difficult when you are selling to the armed forces, which frequently change their mind about specifications.

BAE, understandably, wants a return to the old ways. It thinks the government should take on some of the burden of cost over-runs. That's how new weapons are developed in America. Price competition is limited to production contracts.

One possibility being floated is that BAE and Thales would share the contract. But even if the French win, most of the work will be done in British yards, possibly including those of BAE. Given its lousy record of managing as a prime contractor, that might be the best option for BAE as well as taxpayers.

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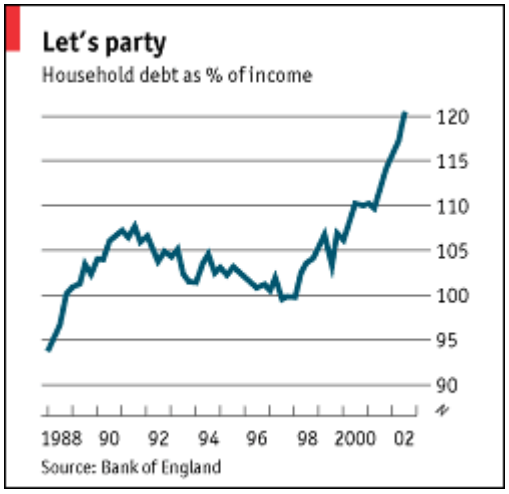
Consumer debt

Too high

Jan 23rd 2003
From The Economist print edition

Households are dangerously reliant on the housing boom ending happily



FOR the past few years, British consumers have been on a borrowing binge. Household debt has risen to record levels both in absolute terms and in relation to household income. Borrowing on properties has recently been growing by 13% a year and consumer credit has been increasing even more briskly. All this money has fuelled a consumer boom that has been vital in sustaining growth during the global slowdown since 2001.

But will the borrowing binge end in tears? This week, Britain's top central banker and financial regulator gave apparently contrasting answers to this question. Sir Edward George, governor of the Bank of England, sought to play down the risk. In a speech to Scottish bankers on January 20th, he cast doubt on the idea that "the household sector will suddenly run for cover in the current environment". But on January 22nd, the Financial Services Authority gave warning that there could be an abrupt retrenchment by consumers, many of whom are already over-stretched.

Sir Edward based his confidence on the fact that the labour market remained robust while inflation was still low, limiting the likelihood of a substantial rise in interest rates. But in its *Financial Risk Outlook* for 2003, the FSA said that one in five families was already finding it difficult to meet their debt repayments. This was a worrying finding because of the degree of financial fragility it revealed even at a time of high employment and with interest rates at a 39-year low.

Tempting though it might be to contrast an oddly insouciant central banker with a worried financial regulator, the clash between the two messages was more apparent than real. Sir Edward was giving his best judgment about the outlook for consumer spending and therefore the economy. The FSA was warning about risks to consumers and the financial-services industry. The FSA's analysis was in effect highlighting the risks to the Bank's central projection for the economy.

The financial regulator's main worry is that the housing market will turn from boom to bust, destabilising the finances of many households. Of the 6m families which the FSA said were already experiencing debt problems, half had mortgages. It was amongst this group—especially people in London and the south-east, where house-price inflation has been especially rapid—that difficulties were concentrated. The FSA warned of the danger that "a disorderly correction in house prices" would pose to the finances of consumers.

If overseas demand were more robust, the economy would be less reliant on consumer spending. But in the four months to January export orders fell at their fastest rate for a year according to a gloomy survey from the Confederation of British Industry. That leaves consumers holding the can once again. Worries that they had lost some of their zest for shopping were dispelled this week by figures showing that retail spending rose by 6.4% in the year to December. Whether consumers can carry on spending like this in 2003, however, depends to a scary extent on an improbably smooth correction to Britain's overheated housing market.

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Volunteering

Scared silly

Jan 23rd 2003
From The Economist print edition

Worries at home and abroad are dimming the do-gooding instinct

COMPARED with riding a bicycle in London, or just living in vibrant urban Britain, a stint working as a volunteer in a poor country seems quite safe. At least it does when you are there. A survey by Voluntary Service Overseas (VSO), an organisation that sends 1,500-odd British health workers, teachers and other professionals abroad each year, shows that around 95% felt as safe or safer than they did at home.

But looked at in advance, volunteering evidently seems much less attractive. VSO is facing the biggest shortfall of recruits in its 45-year history. Since September 11th 2001, the number of volunteers has dropped by 40%.

Direct worries about security are the biggest reason for the fall. Potential volunteers fear they will be the target of terrorist attacks, or caught up in a war. General uncertainty plays a role too: people think now is a bad time to be away from home, family and friends.

Economic difficulties are another factor in determining volunteer numbers—but they have contradictory effects. For some people, a recession is a good time to take two years off, rather than job-hunt fruitlessly at home. Others feel confident enough to take time off in the middle of their career only during a boom.

At first sight, the British outbreak of wimpishness is striking. America's Peace Corps says applications were up by one-sixth last year—something it attributes chiefly to growing interest in the outside world after September 11th. But it is hard to make a direct comparison. Unlike the Peace Corps, VSO does not take idealistic youngsters, but skilled professionals, typically aged in their late 30s. They have more to lose.

The organisation is trying to rally interest, stressing that it does not send people to dangerous or unstable countries (it has pulled out of Zimbabwe and Pakistan, and has never worked in Yemen, where three American medical missionaries were murdered last month). On average only one volunteer dies a year; in the past decade only two have died violently, and no VSO posting has been the subject of a terrorist attack. It also argues that fighting poverty is a good way to make the world safer.

But even persuasive statistics and arguments may not be enough to reverse the trend. Two years abroad, with only pocket money and health insurance paid, may well be stimulating and satisfying. But growing worries about pensions, mortgages, university fee contributions and careers mean that many middle-class professionals feel they have to manage their time and money more carefully—and selfishly—than before.

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Secondary education

Get bac

Jan 23rd 2003
From The Economist print edition

Big changes to the structure and content of secondary education

THE build-up to the government's white paper on university reform was more spun-out and dramatic. But its proposals for secondary education, also announced this week, could be just as important in the longer term. They will determine what older schoolchildren learn and what kind of qualifications they work towards. They also represent a frank acknowledgment of two long-standing problems in British secondary education: the weakness in the quality of vocational courses and the increasing narrowness of the academic track as pupils progress towards university.

The unpopular new A-levels and GCSEs could be scrapped within a decade and replaced by a “baccalaureate-style” qualification demanding a broader range of study. This would probably be something like the International Baccalaureate (IB), which is taught in more than 1,000 schools all over the world, including around 50 in Britain. The government has commissioned a team to think about what an “English bac” might look like.

Meanwhile, new measures will make school more fun and relevant. A quarter of all pupils leave school before they reach 17—one of the highest drop-out rates in Europe. The government reckons that reducing the number of core subjects and increasing the range of vocational courses will make more kids want to stick around.

From September 2004, only English, maths and science will be compulsory for 14-16-year-olds. Foreign languages, along with design and technology, will become optional. This will free up pupils who want to follow a vocational path to spend two days a week attending classes at further education colleges or getting on-the-job training with local employers. More vocational GCSEs and A-levels will be introduced, as well as “hybrid” subjects, which will combine academic and vocational elements. Some of the new “specialist” schools that are replacing “bog-standard” comprehensives may tilt towards either the academic or the vocational.

The current proposals address some big problems. But unsuccessful attempts have been made in the past to bring about “parity of esteem” between academic and vocational courses. And if recent experience is anything to go by, a British version of the bac might well lack the rigour, not to mention the independent marking, that makes the IB a popular choice for ambitious pupils at top schools.

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Bagehot

Equality or efficiency?

Jan 23rd 2003
From The Economist print edition

The rows over university funding have exposed a deep division of principle

THOSE around the world who pay attention to these things will have noticed that Tony Blair has been having a difficult time with both his party and his cabinet over war with Iraq. The row over the financing of universities may have passed them by. But that argument, more even than war, has exposed issues that go straight to this government's divided heart.

On Iraq, Gordon Brown has kept his head down, giving Tony Blair rather more public support than might have been expected. But the universities, especially those with any claim to elite status, turn the chancellor into a rampaging Jacobin, bitterly at odds with the prime minister. The chasm between old and new Labour is widest over education. New Labour wants better schools and universities; old Labour says it does, but actually puts a notion of equality far ahead of efficiency.

The importance for Labour traditionalists of an ideologically-driven egalitarianism when it comes to education policy cannot be exaggerated. After the health service, nothing arouses greater passion in Labour breasts than the explicitly anti-elitist “comprehensive ideal”. Consequently, the destruction of the English grammar schools that Labour embarked on in the mid-1960s, although one of the most damaging acts of political vandalism since the dissolution of the monasteries, remains one of the party's proudest achievements.

Labour’s destruction of the English grammar schools in the mid-1960s remains one of the party’s proudest achievements

While there was much wrong with the way the old system sorted children at 11—sending the academically-able to grammar schools and the less so to secondary moderns—getting rid of the best schools in the name of equality was unlikely to make what replaced it better. As grammar schools were subsumed into the new comprehensive schools, much that was good about their ethos and teaching was jettisoned.

So pervasive was the egalitarian impulse that nearly all comprehensive schools were forced into adopting new “progressive” teaching ideas. Above all, these meant “mixed ability” classes combined with “child-centred” learning. Nice in theory and perhaps manageable given small classes and gifted teachers. But in the majority of schools it was a disaster responsible for generations of ruined lives. Even though the last ten years have seen some return to sanity in the form of a new emphasis on standards and, in many instances, a revival of more traditional and proven teaching methods, the insistence that just one kind of school could serve every child has remained a peculiarly English delusion that the government has only recently had the political courage to challenge.

Higher education has also suffered from misguided egalitarianism. As successive governments have pursued the goal of increasing university participation very rapidly, but doing so on the cheap, two things have happened. The first is that A-levels have been made easier to relax entry standards. The second is that the quality of education offered by universities has declined in proportion to the funding available for each student. Whether attending a tatty former polytechnic or an institution with an international reputation for research, all undergraduates but the very poorest pay the same £1,100 ($1,770) a year tuition fees. Instead of providing an excellent education for the few, Britain's universities offer mediocrity for the many. Inadequate funding has ensured that more means worse.

In many ways, the two big arguments within the Labour Party over education are about the same thing. The egalitarians are horrified at the prospect of growing numbers of new “specialist” schools, which they claim will lead to backdoor selection, and they regard the prime minister's repeated talk of a “post-comprehensive” era in education as nothing less than betrayal. The same people have also been

desperate to use the funding crisis to force a version of comprehensivisation on to the universities. The whole debate over top-up fees has been fuelled by resentment that the value of a degree is a reflection on the prestige of the university that has awarded it and that the market will therefore allow those universities to charge more.

Chancellor Chippy

The fear, for which there is little evidence, that students from poorer backgrounds will be put off incurring the larger debt that going to, say, Oxford or the London School of Economics entails may be genuine. But a loathing of academic elitism lies not far beneath the surface. As for the chancellor, his almost atavistic dislike of Oxbridge is well known. Thus anything that might help the grander universities escape his enthusiasm for social engineering was always bound to meet with his hostility.

To his credit, Charles Clarke, the new education secretary, has (with Mr Blair's support) both stood up to Mr Brown and risked the wrath of his colleagues by introducing the principle of differential fees for university tuition to be repaid after graduation. His main concession to the chancellor has been to agree to a university “access regulator” who is supposed to ensure that efforts are made to recruit more students from poorer families. (Mr Clarke is confident there will be nothing so crude as quotas; the brooding Mr Brown may have other ideas.)

The proposed changes to secondary education are potentially as significant as setting the universities (more or less) free. A pared-down core curriculum and new vocational courses at both GCSE and A-level are sensible enough, but, although ministers are hesitant to say so, it is the spread of specialist schools that gives the plans a real chance of success. This is bound to involve some selection, but that may be no bad thing. Some people are better at some subjects than they are at others. The same kind of education—and school—does not work for everyone. That's true of universities too. This is what the egalitarians cannot bear to admit. And that is why they have, in the past, done terrible harm to those they meant to help.

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Digital dilemmas

Jan 23rd 2003
From The Economist print edition

Despite the dotcom boom and bust, the computer and telecommunications revolution has barely begun. Over the next few decades, the internet and related technologies really will profoundly transform society, argues David Manasian

“GOVERNMENTS of the industrial world, you weary giants of flesh and steel, I come from cyberspace, the new home of mind. On behalf of the future, I ask you of the past to leave us alone. You are not welcome among us. You have no sovereignty where we gather.”

Ah, it all seems so long ago. In 1996 John Perry Barlow, a former cattle rancher, lyricist for a rock band, the Grateful Dead, and commentator on technology, posted these words in an online discussion group. His “Declaration of the Independence of Cyberspace” was an 800-word credo which claimed that users of the internet inhabited a new world of creativity, equality and justice which would forever remain beyond the reach of existing governments. “We will create a civilisation of the mind in cyberspace. May it be more humane and fair than the world your governments have made before,” he concluded with a flourish.

It is hard to believe today, but Mr Barlow's musings struck a chord at the time, spreading rapidly through the internet. The declaration encapsulated the exhilaration and wonder of millions of people as they logged on to the world wide web for the first time. It really did seem possible that the internet had launched a spontaneous revolution that might lead to a brave new borderless world.

Seven years later, Mr Barlow's claims sound absurd: just another example of the 1990s hype that produced the dotcom boom and bust. The internet, it seems, has turned out to be simply another appliance, a useful new medium like radio or television, not something likely to usher in a “civilisation of the mind”. Cyber gurus like Mr Barlow have also lost heart, and now issue equally exaggerated warnings about the internet's strangulation by government and corporate interests. With the help of governments, big entertainment companies are trying to “control everything that we know”, Mr Barlow says. “The fight about this will, in my view, determine the future of humanity.” Lawrence Lessig, a Stanford professor who is also a leading commentator on the internet, is almost equally apocalyptic: “The existing dinosaurs are succeeding in stifling the creativity inherent in this new medium.”

The taste for hyperbole of Mr Barlow, Mr Lessig and their sort may be easy to mock, but they are right in their fundamental claim: the internet and its related technologies are capable of transforming society. Far from being over, the computer and telecoms revolution that created the internet has barely begun. These technologies will change almost every aspect of our lives—private, social, cultural, economic and political. In some areas, the changes may be marginal, but in most they will be profound, and unprecedented.

For good or ill

This is because new electronic technologies deal with the very essence of human society: communication between people. Earlier technologies, from printing to the telegraph, have done likewise, and have wrought big changes over time. But the social changes over the coming decades are likely to be much more extensive, and to happen much faster, than any in the past, because the technologies driving them are continuing to develop at a breakneck pace. More importantly, they look as if together they will be as pervasive and ubiquitous as electricity. Whether this will be for good or ill is impossible to predict, because how they are applied will be a matter of social and political choice. Many of these choices will be difficult and divisive.

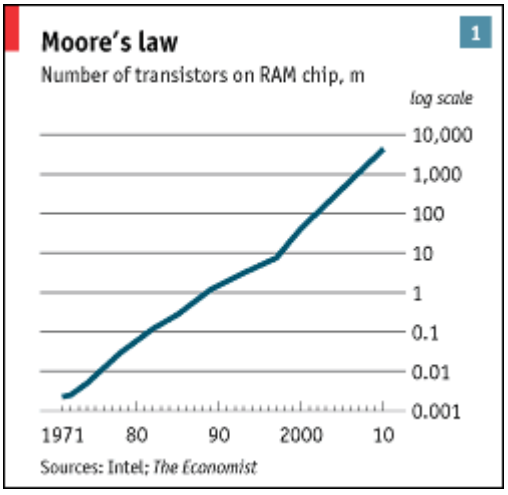
Billions of dollars have been lost betting on the idea that the internet would quickly change everything from retailing to entertainment. Internet usage has continued to grow, but most dotcoms have failed, and the telecommunications industry, which raced to build the infrastructure for cyberspace, is staggering under $1 trillion of debt. Yet it would be wrong to conclude that this is the end of the internet revolution. Boom and bust often follow the introduction of radically new technologies. In the 1870s America's railroad industry boomed in much the same way as the world's telecoms industry in the late 1990s, only to collapse in a similar heap of bankruptcies, accounting scandals, stockmarket losses and enormous debts. America's economy fell into recession.

A few years later, a reviving economy together with advances in railway engineering triggered a new wave of investment. Railroads quickly revived, changing American business forever. The same sort of thing happened when the internal combustion engine came along. In the first few years of the 20th century there were thousands of people tinkering with carmaking, most of whom went bust. A decade later only a handful survived, but the car was about to become the icon of progress.

The reason to think that the internet revolution will not only resume but accelerate is that advances in its underlying technologies show no signs of slowing down. The power of computer chips continues to race ahead. Moore's law—according to which the power of a computer chip will double about every 18 months (see chart 1)—has proved to be true since 1965, when it was first propounded by Gordon Moore, a co-founder of Intel, a chip maker. Intel is confident that it will be able to maintain this pace of improvement in silicon for another 15 years. Recent breakthroughs by researchers at IBM and Hewlett Packard in molecular electronics lead many experts to believe that Moore's law will continue to apply for perhaps another 50 years. Similarly dramatic advances in storage and transmission technologies are also in prospect.

The reason to think that the internet revolution will not only resume but accelerate is that advances in its underlying technologies show no signs of slowing down

Meanwhile, existing or impending technology is being applied ever more widely. Victor Zue, director of MIT's Laboratory for Computer Science, expects high-speed access to the internet to be virtually free in rich countries within five years. His laboratory's Project Oxygen is building an office on MIT's campus in Cambridge, Massachusetts, that will be wired to demonstrate the kind of “pervasive, human-centred computing”, driven by voice and involving a range of devices, that he believes will become possible in the near future. Many of its components are already being tested at MIT's laboratory and by its corporate partners.



On another front, Mr Zue's colleague, Tim Berners-Lee, famous as a founder of the world wide web, is trying to win agreement from a coalition of companies to establish the standards for what he calls the “semantic web”, a more intelligent version of today's internet that will take the drudgery out of searching for information by evaluating its context.

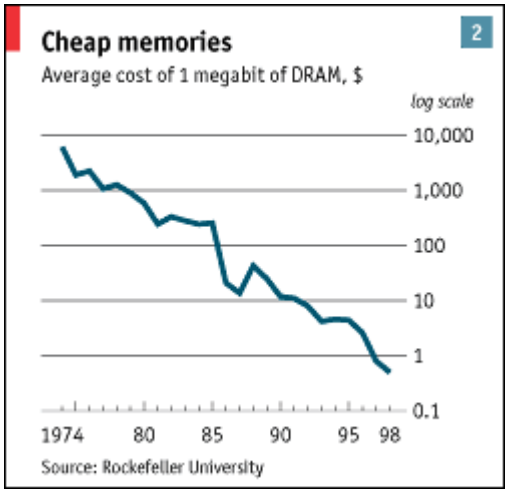
Even the sense of physical touch might some day become possible in cyberspace. Late last year,

scientists at University College in London and MIT in Boston demonstrated a system that allows users at each end of a high-speed connection to manipulate objects, either alone or together. Microsoft researchers are now working on ways for consumers to store and catalogue every photograph, e-mail, document or telephone conversation they have had during their entire lifetime (though it is not clear why anyone not writing an autobiography would want to do this).

There's a chip in my shoulder

On a more mundane level, third-generation mobile telephones, despite all the delays and the billions squandered on 3G licences by telecoms firms, are still expected to offer consumers high-speed, always-on mobile internet access, complete with video, in the next few years. Rapidly proliferating “wi-fi” networks already offer wireless access on a local basis. Tiny tracking chips called radio-frequency identification devices are being used as pet passports. Soon they will be small, powerful and cheap enough to be implanted into everything from humans to milk cartons, recording and transmitting real-time medical data or serving as a form of inventory control. Sensors of every kind, including video cameras, should also become much smaller and cheaper. Forrester Research, a technology consultancy, predicts that 14 billion such devices will be connected to the internet by 2010.

How rapidly such new technology is introduced will depend on a number of factors—the state of the economy, the supply of investment capital and the appetite of consumers for new products or services. Fortunes will be made and lost many times over. But whatever happens, the power of computing and communications looks set to continue to grow, and its price to fall, at a steady rate for the next few decades. That will make it possible, at least in rich countries, to record most human interactions, wherever and whenever they take place, and to store and analyse this ocean of data at low cost.



For the sake of argument, this survey will assume that we are heading towards a networked society of ubiquitous, mobile communications capable of constant monitoring. Whether this arrives in 20, 30 or 40 years does not really matter. The point is that the destination seems not merely possible, but probable, so it is not too soon to ask: what do we want this technology to do?

The internet has already thrown up a host of legal and political conundrums, but these are only a small foretaste of the dilemmas—about privacy, security, intellectual property and the nature of government itself—that will have to be faced over the coming decades. The debate has already begun. This survey will outline some of main issues, and speculate on the way they are likely to go.

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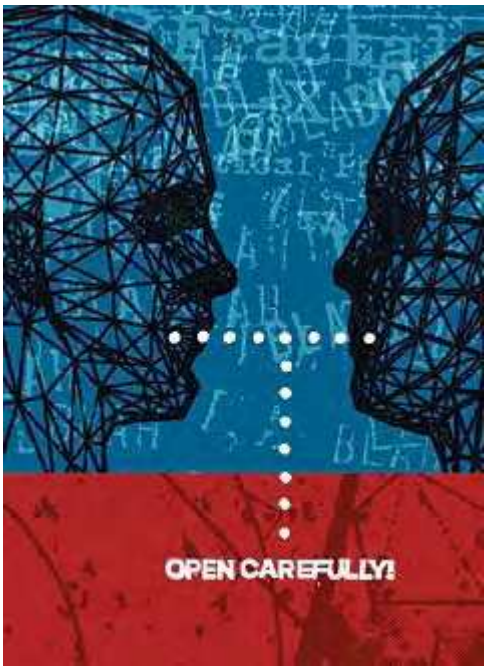
No hiding place

Jan 23rd 2003
From The Economist print edition

The protection of privacy will be a huge problem for the internet society



THE next time you are on the internet, try an experiment. Change the default setting for “cookies” in your web browser from “accept” to “prompt”, or “warn”, or whatever equivalent is offered, then browse the web for a few minutes. You will soon be bombarded with messages telling you that almost every website you visit is trying to plant cookies—small text files that collect information about your browsing habits—on your computer. *The Economist* website is no exception. Your every move on the internet is being recorded by someone, somewhere.

Cookies caused a furore when their widespread use was first publicised years ago, but now they are accepted as standard practice; indeed, their use has expanded vastly, and using the web without them is now virtually impossible. Information they provide is shared by thousands of websites through advertising-network companies. The largest of these, DoubleClick, has agreements with over 11,000 websites and maintains cookies on 100m users. These can be linked to hundreds of pieces of information about each user's browsing behaviour. In addition, users are being tracked through other methods by internet service providers, website hosts and e-mail services.

Offline, too, monitoring of people's behaviour has increased by leaps and bounds in recent years. The use of credit, store and debit cards leaves a trail of electronic data. So does turning on a mobile phone, even if no calls are made or received. The phone operator can not only monitor calls but also record the location of the phone. Electronic systems for public-transport tickets, road tolls and access to buildings of all kinds are expected to spread rapidly. Governments around the world are moving to record their own transactions and the provision of services to their citizens electronically. Monitoring of telephone calls, voicemail, e-mail and computer use by employers is easier and more widespread than ever before.

Cookies caused a furore when their widespread use was first publicised years ago; now they are accepted as standard practice

The use of video surveillance cameras is also growing. Britain has an estimated 1.5m cameras monitoring public places. According to one estimate, the average Briton is recorded by CCTV cameras 300 times a day. As cameras have become cheaper, smaller and more effective, they are proliferating and can now be found almost anywhere: airports, aeroplanes, buses, shopping malls, schools, public buildings, offices, factories and increasingly in people's homes too. Digital cameras allow the images collected to be stored and analysed much faster and more cheaply than in the past.

And this is only the beginning. Engineers are now developing cameras that employ low-level radiation to “see” through clothing, walls or cars. Miniature bugging devices capable of transmitting video or audio signals for miles and for years, commercial satellites powerful enough to recognise objects as small as one metre across, and tiny tracking chips cheap enough to be attached to many products or people are already available. Cheaper and more powerful versions are expected in the next few years. Technologies such as face-recognition software and biometric identification, which security experts say are not yet reliable enough, are being installed nevertheless, and will improve over the coming decade, as will the ability to crunch and analyse the mountain of data generated by all this monitoring.

Get off my back

In other words, a society capable of constant and pervasive surveillance is being rapidly built around us, sometimes with our co-operation, more often without our knowledge. Opinion polls consistently show that the public would prefer more privacy, and is concerned about its erosion. Occasionally there is a burst of publicity about some particularly intrusive new method of data collection. But once the fuss is over, the public acquiesces in the surrender of more information—until the next revelation.

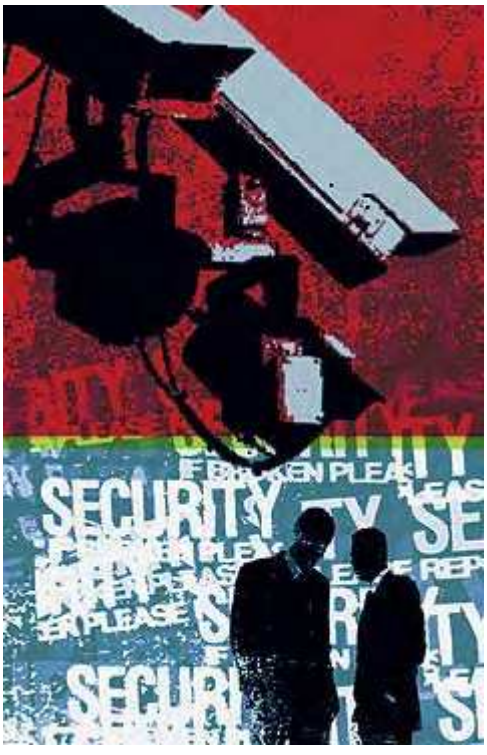
This is what has happened since the terrorist attacks of September 11th 2001. Governments everywhere, not just in the United States, have rushed to expand their powers of surveillance. Even the European Union, which has long been at loggerheads with America about data protection, performed a sharp U-turn, relaxing legal restraints on the collection and use of information by governments. Last June the EU adopted a new directive to allow member states to require firms to retain data on everyone using mobile phones, landlines, e-mails, chatrooms, the internet or any other electronic device. In America, the USA Patriot Act, passed in the wake of September 11th, made it much easier for the authorities to obtain court permission to monitor internet traffic and obtain wiretaps. The technology to do this is being built into the internet's infrastructure. Campaigners for privacy protection sometimes give the impression that the battle is already lost.

That may be the wrong conclusion. Instead, privacy is likely to become one of the most contentious and troublesome issues in western politics. There will be constant arguments about what trade-offs to make between privacy on the one hand and security, economic efficiency and convenience on the other. Most people are repelled by the idea of near-constant surveillance, but they either find it difficult to believe that it will really happen, or they do not know how to stop it.

Salami technique

One problem is that privacy is hard to define or protect in the abstract. Presented with the prospect of losing it, many people might well prefer to eschew the substantial benefits that new technology offers. But they will not, in practice, be offered that choice. Instead, each benefit—more security against terrorists or criminals, better government services, higher productivity at work, better medical care, a wider selection of products, more convenience, more entertainment—will seem worth the surrender of a bit more personal information, or a marginal increase in monitoring. Yet the cumulative effect of these bargains, each seemingly attractive on its own, will be the relentless destruction of privacy.

A second difficulty is that privacy is such a subjective concept. Some people will love being able to keep track of their partner every moment of the day or night, others will loathe the idea. Some people will resist being observed by video cameras at work, at play and everywhere in-between, others will find it comforting. Individuals are likely to find it hard or impossible to opt out of these new systems. Decisions on where to draw the line on privacy must, for the most part, be collective ones, and stopping the introduction of new privacy-destroying technology will call for a degree of consensus that will be hard to achieve.



The debate is being complicated by the distinction between the collection of information by governments and by the private sector. For understandable reasons, governments remain the larger worry for most people. In the 20th century it was Big Brother governments, not marketing firms, that became nightmares. And yet in the networked society of the future it could well prove easier to tame an overly intrusive government than a private sector hungry for more and more information. An entrepreneurial private sector, driven by competition to seize on every new technological possibility, is likely to find ways round most obstacles placed in its way. And whatever information the private sector collects will be accessible to the government too, through subpoenas and search warrants. E-mails have already become a staple of court cases.

It does not help that the issue of privacy does not fit conveniently into existing political frameworks. Privacy defenders have come from across the political

In the networked

spectrum, as have its opponents, and the debate has already produced some strange political bedfellows. Social conservatives are usually suspicious of government meddling, but many, especially in America, think that personal privacy is being used as a cover for activities they disapprove of, such as abortion or homosexuality. Their opponents among radical feminists and left-wing advocates of political correctness have also sometimes argued against privacy rights, but for different reasons, dismissing them as a means of cloaking patriarchal oppression, racial abuse and a host of other evils. Both, in their way, have supported intrusions into private lives to achieve social-engineering goals.

society of the future it could well prove easier to tame an overly intrusive government than a private sector hungry for more and more information

Even some libertarians, for whom individual privacy should be a precious good, have argued against regulating the collection of data by companies as an infringement of corporate rights, both of free speech (in reporting transactions with their customers) and of the general right of human beings to learn about one another in an open society. At the other end of the political spectrum, Amitai Etzioni, America's leading communitarian, detects a “pro-privacy” bias in American life, though mainly because, unlike his libertarian opponents, he wants to let the government exploit the advantages of new technologies through a national ID card and greater access to private databases.

Nothing is perfect

If any degree of privacy is to be retained in the face of technological advances already on the horizon, an array of measures must be employed—though all have drawbacks:

• **Legislation**. The right to privacy is enshrined in most national constitutions as well as in international human-rights treaties, and protected by a host of laws, but legislation has proved a porous barrier to the rising tide of electronic monitoring. By its nature, the law tends to lag behind new technological developments, so it often regulates past rather than present or future threats to privacy. And in a globally wired world, nationally based privacy laws may no longer be effective. Moreover, legal remedies must be pursued by individual citizens, who may not have the time or the resources required.

America's consumer-credit laws, passed in the 1970s, give individuals the right to examine their credit records and to demand corrections. The EU Data Protection directive, which came into force in 1998, goes a lot further, aiming to give people control over their data and requiring “unambiguous” consent before a company or agency can process them. But so far it has had little effect. One giant loophole was left by the lack of agreement with the United States, which refused to pass a similar law. To avoid a trade war over the issue, the EU had to offer a “safe harbour” from EU legal action for American firms that promised to abide by a set of rules guaranteeing the rights of EU consumers. In fact, few individuals have been determined enough to pursue their rights either under the EU law or through the EU-American “safe harbour” agreement. And yet in a recent survey of 10,000 people by the European Commission, most said they felt their personal information was insufficiently protected.

• **Market solutions**. Self-regulation, the approach favoured by the United States, seems to have left consumers even less reassured. Last August, Microsoft agreed that the Federal Trade Commission, which had accused the company of breaching its privacy promises to consumers, should monitor Microsoft's Passport identification system for the next 20 years. The company is a key member of “Truste”, one of the computer and telecommunications industries' leading self-regulatory groups, but Truste clearly failed to notice the breach.

A popular idea in the 1990s was that firms called “infomediaries” would emerge as brokers of information between consumers and other companies. They would release only such data as individuals were happy to reveal, and protect the rest. So far, however, the only real infomediaries have been firms such as Microsoft and AOL, which have the most to gain by commercially exploiting their huge databases on users. Many companies already promise that they will not sell information they collect about their customers, but such pledges are not always kept. In a world where most transactions in life are conducted electronically, consumers who want privacy would have to be ever vigilant, constantly making decisions about how much information they were willing to give away in exchange for other benefits. As is already clear, this is more than most can manage. Besides, market solutions are unlikely to be able to deal with growing government databases or increased surveillance in public places.

• **Technology**. In the 1990s a fierce war was waged between encryption fans on the internet on the one

hand and governments, especially America's, on the other. The governments argued that they needed access to encryption keys to be able to enforce the law. They largely lost, mainly because they could find no guaranteed way to crack sophisticated new codes, though most governments retain the legal right to demand keys from suspects in criminal cases. In fact, few people, even terrorists, use encryption regularly. Fewer still use specialised internet portals that guarantee anonymous browsing. This could change if concern about web privacy grows. But technology can only ever be a partial answer. Privacy will be threatened not only by government or private snooping, but by the constant recording of all sorts of information that individuals must provide to receive products or benefits—which is as true off as on the internet.

Ironically, the most effective solution to the privacy problem may be something that most privacy defenders fiercely resist: a highly secure identification system, perhaps linked to two or three different biometric measures. True, this would give a great boost to ubiquitous monitoring, but it would also make it possible to track precisely who taps into databases. This seems essential if access to databases is ever going to be properly controlled.

Try transparency

Given the sheer difficulty of protecting privacy in the face of ever more sophisticated technology, is it worth even trying? David Brin, a physicist and science-fiction writer, has attracted a lot of attention with his 1998 book “The Transparent Society”, in which he argues for much less, not more, privacy protection. Attempts to protect privacy usually benefit only the rich and powerful, or else the government, he says. Transparency is almost always a better option. Let everyone have access to databases, peer through CCTV cameras and listen in on conversations, Mr Brin says. “Mutually assured surveillance” would see to it that most people did not abuse their access to information.

The trouble is that, on current evidence, most people would be unwilling to live with such an arrangement. In “The Truman Show”, a recent Hollywood film, the hero abandons the only life he knows to evade the pitiless gaze of the cameras, having discovered that he has been the subject of a reality-TV show since birth. His bid for freedom is a desperate attempt to retrieve his humanity, something that most people would sympathise with. Every society, however primitive or poor, has had some concept of privacy, and has employed mechanisms to protect it. Despite the relentless advance of monitoring, the odds are that, in some form difficult to specify as yet, privacy will survive.

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Only disconnect

Jan 23rd 2003
From The Economist print edition

A taste of life in 2033

JANE remembers her parents saying they spent a lot of time getting the kids off to school and then fighting their way into work through rush-hour traffic to sit at a desk in front of a big square box that would often “crash”. Thank heavens life is so much easier now. Rush hours were eliminated years ago: Jane works when it suits her, and carries her office around in her pocket. The files she needs from work fit on a square-inch memory chip. Anything else she wants, including the three dozen newspapers and magazines she likes to skim regularly, she can get anywhere from the web. Sometimes she still meets her colleagues in the same room for “face time”, but she thinks this is overrated. Usually three-dimensional video does just as well.

The vast increases in productivity over the past decade mean that Jane has a lot of free time. She loves being involved in the big issues of the day, so she briefs herself on politics and votes on some of the half-dozen referendums held every day. A pity that so few people bother.

Crime and terrorism were virtually eliminated a decade ago. A few people still misbehave, but with constant surveillance it is hard to get away with anything. Fraud and stalking were wiped out when DNA-matching instant identification was narrowly approved in a national referendum a few years ago.

Jane barely remembers that initial terrorist attack on September 11th 2001, but recalls the years of constant fear afterwards, leading to the referendum that gave the authorities almost complete surveillance rights over everyone and everything. And when web technology gelled a few years later, terrorism just stopped.

Private life, too, has got a lot easier. Most of the “drudge” shopping for food and other essentials is done automatically: all Jane has to do is to set the inventory levels in her kitchen. That leaves more time for fun shopping, say for clothes. She also likes the reassurance she gets from the implanted medical chips that transmit her data to her doctor's information base.

Jane always knows where her kids are because she can call them up on screen. They are too busy to get into much mischief anyway, with the round-the-clock edutainment she has scheduled for them. Indeed, she knows the whereabouts of everyone who matters to her, and can contact them at the press of a button. If only her husband Dick would cheer up.

You'll never walk alone

Dick is depressed. He does not feel it is enough to talk to Jane on video a dozen times a day, and get together a few times a week for sex. Yes, watching the football together last night via video was fun, and Jane picked some great camera angles to look at the game from. They laughed so much that he wanted to send a clip from Jane's video to Harry at university, but the boy had someone with him and had blocked the cameras in his room. That made Dick feel wistful. It would have been nice for Jane and him to be in the same room together too. If she would just stop attending political meetings and voting so much, they might have more time to spend with each other.

Dick is bored with his job, but that isn't his main problem. He just feels watched all the time, even though Jane has explained to him that only those with authorised access can know what he is doing. He is not so sure. Certainly, all kinds of strangers—his personal tax collector, officials at the town hall—seem to know an awful lot about him. And he really dislikes the idea that everything he does is poured into a database. He wants another beer, but everyone will know about it—the supermarket, Jane, his doctor. The trouble is, he is slightly older than Jane, and can still remember a time when it was possible to be alone.

Certainly he doesn't agree with Jane that everything is perfect. Yes, travel is much easier than it used to be, because everything is arranged instantly on the web. But there are parts of the world he cannot visit any more because the political oppression there is just too frightening. And life at home is such a treadmill. Dick's boss is demanding live access for more and more hours of the day, and video messages are always piling up. To escape these pressures, Dick spends too much on entertainment, but to pay those big bills he has to spend yet more hours at work. He deeply resents Microdisneysoft charging for absolutely everything, and Timesonywarner isn't much better.

Maybe his father has the right idea. Dick hardly sees the old man these days because he always seems to have his video image and live-communicator access blocked. Blocking access is considered rude, even suspicious, but Dick wonders if he shouldn't do the same.

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A fine balance

Jan 23rd 2003
From The Economist print edition

How much copyright protection does the internet need?

THE subject sounds as dry as dust, but the debate on copyright has been extremely lively. On one side stand the entertainment and publishing industries, and the intellectual property lawyers who make their living from them. On the other is a motley collection of consumer advocates, law-school professors and cyber-libertarians. Both sides claim that nothing less is at stake than the future of creative endeavour itself. Will the internet and related technologies unleash an unprecedented burst of intellectual and artistic effort, benefiting producer and consumer alike? Or will the web end up as an intellectual wasteland, deprived of content by the fear of rampant copying?

It may seem that both sides are being alarmist. After all, huge quantities of copyrighted material circulate on the web every day, and as yet neither the content industries nor the internet seem to have done each other much harm. Even the record companies have failed to prove their claim that file-sharing services such as Napster, which they succeeded in closing down last year with a copyright-infringement suit, have done much damage to their sales, which may have declined for a variety of other reasons.

But both sides are less concerned with the present than with the future, when a more powerful and ubiquitous internet could make child's play of the perfect copying and global distribution of any recorded material—text, images, music or video. So far, neither side has come up with any persuasive ideas on how copyrighted material can be protected on the internet without extinguishing many of the web's promised benefits.

What the content industries envisage is a combination of tough legal and technological protections that will enable them to stamp out nearly all unauthorised copying and to exert direct control over what their customers can do with their products. The music, television and movie industries, initially befuddled by the rapid growth of the web and the sudden proliferation of file-sharing programs, soon launched a concerted effort to stop what they view as large-scale theft. They have had mixed success. The record companies managed to shut down Napster, but other, less centralised file-sharing services have sprung up in its place. Large quantities of music continue to circulate on the internet. The swapping of movies and television shows is also slowly taking off and could soar as high-speed internet access spreads.

In 1998 Hollywood, already foreseeing the mortal danger that digitisation might bring, conducted a vigorous lobbying campaign to win two pieces of legislation from America's Congress. One extended the length of American copyrights. The second, and far more controversial, was the Digital Millennium Copyright Act (DMCA), which declared that “no person shall circumvent a technological measure that effectively controls access to a work protected” by copyright. In other words, the DMCA made it a crime not only to copy a protected work, but to unscramble an encrypted work without authorisation. It also

made it illegal to manufacture, release or sell any tools, hardware or software designed to help anyone crack encryption of a copyrighted work.

The content industries are currently seeking yet more legal weapons, including a requirement to install anti-piracy software or chips in computers, handheld organisers and so on. But their schemes for copyright protection have not got very far, partly because there is no agreement on technological standards, and partly because the software and electronics industries are reluctant to annoy their customers, or possibly torpedo their own sales, by helping to impose restrictions on the use of content. This conflict of short-term interests could delay an agreement between Hollywood and Silicon Valley for some time. But it would be foolish to assume that no agreement is possible in the long term. Computer makers and consumer-electronics firms need a steady stream of enticing content to sell their goods. Eventually equipment manufacturers and content providers will come to some agreement on how to protect digital content.

Fair enough?

Whatever deal they do strike will not necessarily be in the best interests of the public, and is likely to enrage the growing band of vocal cyber-activists who consider Hollywood's aims as an assault on basic liberties. “Rather than ‘wait and see', the law has become the willing tool of those who would protect what they have against the innovation the net could promise,” writes Stanford's Mr Lessig in his most recent book, “The Future of Ideas: the Fate of the Commons in a Connected World”.

Mr Lessig and others point out that most cultural and intellectual creativity makes use of existing work in some way. Blocking access to the immediate cultural past with a battery of legal and technological barriers, they claim, will crush creativity just at the moment when technology has given the tools for creativity to hundreds of millions of people. Moreover, if the content industries get their way, the “fair use” provisions which have always ensured access even to copyrighted works will be brushed aside. Government should stay its hand and let new business models emerge as technology develops.

Hollywood and the music industry fear that as technology improves, their existing assets will simply evaporate into cyberspace. They are not going to sit idly by and watch that happen. Yet their critics have some powerful points. To understand these, it is necessary to take a closer look at copyright law itself.

Ever since its foundations were laid in Britain and America in the 18th century, copyright law has tried to strike a balance between offering an incentive to writers and publishers to create and disseminate works, and guaranteeing public access to the flow of ideas. The thought behind this is that “intellectual property”, as published work and inventions have since become known, is different in kind from tangible property. Economists call ideas, and their expression, “non-rivalrous”—for example, if I take your car, you are left without a car, but if I borrow or steal your idea, we can both use it. As Thomas Jefferson famously put it: “He who receives an idea from me, receives instruction himself without lessening mine; as he who lights his taper at mine, receives light without darkening me.” Whereas all tangible property is scarce, ideas or their expression are not. Copyright is the grant of a temporary monopoly, through a ban on copying, to offer those who generate ideas a chance to garner a profit.

Over time, copyright has repeatedly been strengthened and extended as the publishing and entertainment industries have become ever more important and as new technology has posed new problems. For example, the first American copyright law of 1790 borrowed the contemporary British scheme of granting 14-year copyrights, renewable for another 14 years. Today both American and European copyrights, harmonised by treaty, are for 70 years beyond the life of the author and 95 years after publication, or 125 years after creation for works made “for hire” and owned by corporations.

Copyright has also been extended far beyond printed works to cover almost any medium from choreography to music, movies and computer programs. In the process, one initial element of copyright, the notion that only the specific expression of an idea could be protected, not the idea itself, has been eroded by the extension of copyright to translations and derivatives of the original. Moreover, constraints such as the need to register a copyright have been swept away. The mere creation of a work in some tangible form results in a copyright.

Despite these extensions, the balance between the public's access to new ideas and the incentive to creators to produce and publish them has largely been preserved. Some important exemptions to copyright have been retained. Copying works solely for private use is allowed, as is small-scale copying by schools and libraries. And “fair use” provisions allow others to quote short sections of a work to

comment on it. Big advances in the technological ability to copy works, such as photocopying and the video cassette recorder, have produced much debate but failed to upset this delicate balance.

Perfect reproduction

Digital technology, though, may shatter it once and for all. The technology is reducing the cost of publishing and distributing works to almost zero, which should be a boon for creative people, but has also made the unauthorised copying of works virtually costless and, more important, perfect. In retrospect, the copyright balancing act has survived only because of the imperfections of earlier copying methods.

Content industries want to respond by abandoning the idea of balance altogether. Through a combination of software encryption and new hardware, known as Digital Rights Management (DRM), they want to make digital copying of their work impossible without their permission. They also want a legal framework that allows them to enforce and protect their rights. For them, intellectual property is property, pure and simple.

Their critics claim that this defeats one of the main purposes of copyright—to ensure the public's access to intellectual products—just as the internet should be making that easier than ever. If content industries get their way, the critics say, content providers will gain unprecedented control over consumers. It is impossible to view or listen to digital content without making a copy of it, so even this simple activity could be subject to a payment. Private copying that is now entirely legal, for listening to music or reading text on more than one device for example, would also become subject to the permission of the record company or publisher. “Fair use” would no longer apply, which would inhibit perfectly legitimate comment and debate and pose a threat to the vitality of democracy as well as future creativity. Moreover, once the DRM architecture is built into the software and hardware of the internet, critics say, it will quickly be put to other uses by governments and companies, destroying any chance of privacy and perhaps making even the circulation of works in the public domain difficult or impossible.

Some intriguing suggestions have been made for trying to restore the copyright balance in the digital age. In her book “Digital Copyright”, Jessica Litman argues that any attempt to regulate copying should be abandoned. Instead, the law should give creators the exclusive right of commercial exploitation of their works. Most of the public, she maintains, believe that copyright laws already incorporate that distinction. They do not, but in practice this is what their enforcement often means.

William Fisher, the co-director of the Berkman Centre for Internet and Society at Harvard, proposes that access to the internet and all electronic equipment that uses digital content be taxed, and that the revenues from this tax be distributed to content providers. Under this scheme, all digital content would be “watermarked”, and estimates of downloads would be made using data provided by content providers. A similar system is already used to compensate musicians for free-to-air radio broadcasts of their work. Under Mr Fisher's proposal, consumers on the internet would experience content as “free” but would be paying for it through taxes.

Mr Lessig favours a range of old and new measures. He wants to return to registering copyright, rather than automatically granting it to all content at the moment of its creation. Copyright holders would have to renew their copyright every five years to retain it, with a limit on the number of renewals. Moreover, given the ease of publication in the digital era, the rule would be “use it or lose it”. If a copyright holder was not making a work available to the public, he would be obliged to grant a licence to anyone who did want to publish and distribute the work. The terms of these licences would be set by the government to reward creators, but also to encourage the maximum distribution and use of their work.

Imperfect remedies

These are ingenious remedies, but inevitably there are problems with all of them. Ms Litman's proposal would be likely to produce a wave of litigation as courts struggled to define commercial exploitation and to determine whether a content provider's right to it had been damaged by, for example, someone else's mass copying of their output even if the copyist did not do it for a profit. Mr Fisher's scheme would not only require large-scale government intervention, but make differential pricing by content providers next to impossible and tax the very products that are making the digital revolution possible.

Mr Lessig's ideas may be the most practical, but these, too, would require more government meddling in

all types of digital output. There would be constant disputes about the terms of his compulsory licences. Moreover, what he is suggesting amounts to a dramatic reduction in the reach and value of copyrights. On balance that would probably be good for the public, as he claims, but the content industries could be expected to fight it tooth and nail.

What would happen if the content industries, through a combination of law and technology, were to achieve total copyright protection of their works? Oddly enough, this might not be as comfortable for them as they believe, nor as disastrous for the public as their critics fear, for two reasons. First, one of the most startling things about the internet has been the vast volume of free content that it immediately made available, and that has continued to grow by leaps and bounds. Not everyone wants to get rich from creative work. Millions of people seem more intent on reaching an audience than generating revenue, and do not need the incentive of copyright protection to create something. They include some established writers, artists, musicians and film makers, as well as legions of wannabes.

Second, digital technology is not only making it easier to copy and distribute content, but also to generate it. This is true even of the most expensive medium of all, movies. If content industries overplay their hand, they could end up alienating and losing much of their audience. They are, after all, only intermediaries between creators and consumers. The public may not be willing to tolerate the control of their behaviour that DRM schemes would impose. People may accept copy protections on some products, but are likely to refuse to buy machines which make it hard to copy content in the public domain.

If content industries overplay their hand, they could end up alienating and losing much of their audience

Conversely, what would happen if copyright were to be abolished entirely, as many cyber-libertarians advocate? Again, this might not prove as liberating as they hope, at least in the short term. Content industries would be unlikely to realise their threat to withhold their products from the digital marketplace. Instead, they might digitise everything as fast as possible, but rely more than ever on technological rather than legal protection. In any race with hackers trying to break through encryption barriers, the media companies would probably stay far enough ahead to suppress most piracy. Governments might do more to criminalise attempts to break these barriers, as Congress did in passing the DMCA. But even if they balked at this, they would be unlikely ever to ban the erection of such barriers.

In this scenario, the most commercial books, music and movies would remain behind a pay barrier. “Fair use” of these would be lost, unless granted by the creator, and copies that consumers could make for private use would be tightly controlled. It is true that, without legal backing, this control would endure only as long as the copy protection withstood technological advances, but content providers would probably also experiment with business models other than outright sale, such as subscription and advertising.

Ironically, these two outcomes seem rather similar. So is the debate about copyright irrelevant? Eventually, perhaps. But first there will be constant warfare between those who see copyright protection as a threat to the new digital world, and those who see that world as a threat to their wallets. Certainly, the content industries are likely to experience the most upheaval. They may be able to retard the growth of copying on the internet for a time, but they cannot hold back the advance of technology altogether. This will undermine their existing business models, based as they are on print, analogue broadcasting and the sale of physical products such as compact discs. Even if the “total copyright protection” scenario sketched above prevails, content providers will have to reinvent themselves. But whatever happens, creativity is unlikely to grind to a halt. The show must go on.

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Power to the people

Jan 23rd 2003
From The Economist print edition

A pervasive web will increase demands for direct democracy

IN THE early, heady days of the internet, many of its most zealous proponents expected cyberspace to transform the political landscape. Autocratic governments, they thought, would be scuppered by their inability to control the free flow of information. That could yet happen (see article). But cyber-optimists' hopes were even higher for established democracies, where they saw the internet restoring the electorate's civic engagement. Citizens would no longer have to rely on information spoon-fed by politicians, but be able to find out for themselves. Eventually, people would vote directly from the comfort of their own homes. The political apathy which has spread through western countries in recent decades would be reversed. Democracy would be rejuvenated, at last achieving its original meaning of “power of the people”.

Judging by the most obvious political effects of the internet, so far this has not happened. Established democratic governments have published enormous amounts of information on the internet and moved towards the electronic delivery of some services, but this does not seem to have made much of a difference to the conduct of politics. The structures of democratic government remain intact. Political parties and candidates have set up websites and flooded voters with e-mails. But internet campaigns, according to most studies, have appealed to the same band of already committed voters who are also reached through letter boxes and by knocking on doors. Broadcast advertising still dominates campaign spending.

Governments in Britain and the United States have conducted experiments with electronic voting in real campaigns. A number of European countries are also planning trials. Some experiments have produced a rise in voter turnout, as hoped, but most have not. On the whole, the internet seems to have had remarkably little impact on mainstream politics.

That will not remain true for much longer. Communication is the lifeblood of politics, and every big change in communication technology, from the printing press to television, has eventually produced big, and often unexpected, changes in politics. As the internet becomes mobile and ubiquitous, it will bring about changes of its own. Precisely what these will be is not yet clear, but the earliest claims of cyber-dreamers—that the internet will produce a shift of power away from political elites to ordinary citizens—may well become reality. One of the big political debates of the next three decades will be about the relative merits of direct versus representative democracy.

A different kind of politics

Indeed, it has already got under way. In a recent book, “Democratic Phoenix: Reinventing Political Activism”, Pippa Norris, a political scientist at the Kennedy School of Government at Harvard, rejects the conventional view that there has been a pervasive decline in political participation in western democracies. Voter turnout and membership of political parties may have declined in some countries, she concedes, but much more political activity is now being channelled through single-issue, grass-roots organisations and expressed by means of “protest politics”, such as petitions, demonstrations and consumer boycotts. This trend was well established before the internet, but the web's arrival has accelerated it. The ability to organise, proselytise and communicate at low cost has been a huge boost to such groups, be it a locally based effort to block an airport expansion or a global environmental campaigner such as Greenpeace.

Joining in a protest or a web discussion is not the same as stuffing envelopes for a big political party, but it is political participation nevertheless. According to Ms Norris, survey evidence shows that this kind of protest politics is particularly strong among the well-educated managerial and professional classes in post-industrial societies, and that it is no longer confined to the young. In other words, the bulk of those who are organising themselves on the internet and engaging in “direct action” politics are not anarchists or anti-globalisation protesters, but the kind of people who join political parties and are most likely to vote.

The growth of “protest” politics is not the only evidence for a slowly mounting demand for direct democracy. Over the past few decades, the popularity of direct voting by electorates has sharply increased. Through a variety of mechanisms—local and national referendums, initiatives placed on the ballot by citizens, and advisory votes—governments are now consulting their electorates directly.

Not all such plebiscites are respectable. When Saddam Hussein pushed up the proportion of voters approving his rule from 99.96% to 100% in a referendum last October, the rest of the world could only laugh at the sick joke. But such manipulation does not invalidate the device itself, properly used. Referendums have helped establish popular approval for new constitutions in eastern Europe, accompanied the periodic reforms of the European Union, sometimes with surprising and awkward results, and have been embraced even by Britain, a country with a strong tradition of parliamentary sovereignty.

Vote often

In Switzerland, where various forms of direct democracy have long been an integral feature of government, the number of direct ballots has climbed sharply in recent decades. The same is true in the United States, where direct votes of one kind or another have been used since colonial times. Since 1980 there have been more than 600 state-wide direct votes, and thousands more at city and county level. Twenty-seven American states now have a provision for some form of direct ballot. In some states, such as California, Oregon and Colorado, voters face a slate of referendums every year.

Moreover, public-opinion polling has become endemic in most democracies, with politicians, political parties, the media and even governments continually conducting polls to gauge opinion. Instant, and blatantly unscientific, polls have become a regular feature of news shows and websites. Even that most passive of all media, broadcast television, has spawned scores of websites where couch potatoes passionately debate popular shows such as “The Sopranos” or “Buffy the Vampire Slayer”. These sites are now monitored by television producers to see how audiences are reacting, episode by episode.

In modern societies, in other words, the public is now accustomed to being consulted regularly, and when most people get the chance, they like expressing their view on anything under the sun. Although representative democracy is the basic structure of all western governments, it is accompanied today by a penumbra of direct popular control. Opinion polls in America and Europe suggest that large majorities are in favour of referendums.

Not everyone is happy about this. Politicians are regularly derided for being “poll driven”, as if that were a synonym for public pandering. David Broder, a veteran political reporter and columnist on the *Washington Post*, entitled his recent book about America's initiative campaigns “Democracy Derailed”. Mr Broder is appalled by the intrusion of direct ballots into the governance of American states, believing that such ballots are too vulnerable to control by powerful moneyed interests—a remarkable claim for someone who has been covering America's Congress for most of his career.

And yet despite his scathing criticism of such initiatives, Mr Broder is honest enough to report that his view is not widely shared by voters. “In every state I visited in my reporting, the initiative process was viewed as sacrosanct,” he writes. “In most of them, the legislature (even though term-limited) was in disrepute.” Moreover, he is convinced that it will not be long “before the converging forces of technology and public opinion coalesce in a political movement for a national initiative—to allow the public to substitute the simplicity of majority rule by referendum for what must seem to many frustrated Americans the arcane, ineffective, out-of-date model of the constitution.”

Mr Broder is right, and not just about America. The growing expectations of an educated public for whom individual choice is an important value, combined with the technology of an increasingly pervasive internet, will challenge the structures of all western governments based on representative models of democracy. Once reliable methods for validating electronic votes have been found and internet

penetration rates approach saturation, the internet will remove the biggest single obstacle to direct democracy—the physical difficulty of distributing information to a large population, engaging it in debate and collecting its votes. When this happens, probably during the next decade, many people will come to see national elections every few years as an extraordinarily blunt instrument for expressing the popular will, a remnant from the age of steam, when most representative institutions were invented.

Constitutional change is never easy, nor should it be; and moves towards direct democracy are likely to be fiercely resisted, by politicians and lobbyists out of self-interest, by many others out of a genuine fear of the unknown and by some, like Mr Broder, out of a principled belief that, even if technically possible, government by referendum would be a “tragic mistake”.

The many faces of democracy

Assuming that frequent mass polls will become a practical possibility, critics of direct democracy will argue that, without intermediary institutions such as political parties and legislatures, the kind of rational trade-offs necessary for good government will become impossible. The bargaining that takes place in legislatures may not be pretty, but without it successive referendums are likely to result in contradictory policymaking and instability. Critics will also say that most citizens simply do not have the expertise or the time to examine the complex issues that must constantly be decided in modern societies. Impatient or distracted by other demands on their attention, voters will be prone to snap judgments and vulnerable to manipulation. Professional politicians, for all their faults, do serve a useful purpose.

Those arguing for more direct democracy will reply that regular polls of the electorate should go a long way towards avoiding irrational policymaking. If voters find that they have made conflicting decisions, then another ballot can be held to resolve them. Moreover, even in a direct democracy not all intermediary institutions, such as political parties, government departments or even legislatures, will necessarily be abolished. Legislatures might survive to monitor elected governments, just as they do today, and to formulate and propose legislation. Voters might confine themselves to making the final decision about what legislation to enact. Evidence from the hundreds of initiatives held in Switzerland and in American states does not bear out fears that voters will take undue risks or oppress minorities. Electorates are generally risk-averse, upholding the status quo unless they are thoroughly convinced that change is needed.

Even in a direct democracy, most people do not want to live, eat and sleep politics, so new intermediate institutions may have to be found. James Fishkin, a political scientist at the University of Texas, has experimented with “deliberative polls”, both national and local, in the United States, Britain, Denmark, Australia and Bulgaria. These polls are, in effect, large juries of ordinary voters (200-500 people at a time), selected to mirror the general population, who gather to interrogate experts on both sides of an issue over a couple of days and then debate among themselves in moderated groups. Participants are polled both before and after their discussions to see what difference these have made.

Mr Fishkin's results have been encouraging. Minds were opened and some attitudes changed. Judging by the evidence of lengthy questionnaires before and after each poll, it seems that all socio-economic groups (not just the rich or well-educated) are capable of considering complex issues; that participants are able to absorb information even if it clashes with their own views; and that such groups are able to weigh alternatives and set priorities even when difficult trade-offs are involved.

The jury is out

In a direct democracy, voters might well trust such juries of fellow citizens more than they would groups of professional politicians. With a ubiquitous, video-enabled internet, such juries would not need to assemble physically, as did most of Mr Fishkin's. Voters could follow the deliberations of the group as it wrestled with a decision, review the evidence presented to the jurors, and consider the jury's decision when it was made. Juries could be used as advisers to the electorate before votes, or some decisions could be delegated directly to the juries themselves. A poll by the Center on Policy Attitudes, a Washington-based think-tank, found that two out of three Americans believed that such a jury would make better decisions than Congress, mainly because it would be less subject to lobbyists' attempts to influence it.

Such innovations may still seem a long way off. But in trying to hold back the demand for more direct democracy, the defenders of traditional representative institutions will have a fundamental problem: any

criticism they make will sound as though it is aimed at democracy itself. If voters are not wise enough to make direct policy choices, how can they be wise enough to choose legislators, or governments, to do it for them?

The financial corruption and lobbying by special interests that plague all democracies today are much harder to stamp out in a representative system than they would be in a system with more direct voter involvement. Mr Broder is right that big-money interests have also tried to manipulate many American initiative ballots. But it is hard to bribe an entire electorate, or even to mislead it for very long, if there is a free flow of information and open discussion. In any case, most research by political scientists has found that, contrary to Mr Broder's view, state-wide initiative campaigns are, on the whole, remarkably difficult for big spenders to control.

To function effectively, of course, even direct democracies will need rules, procedures and an array of institutions. Most of these are likely to be adapted from existing ones. Others will have to be invented, and voters persuaded of their merits. One of democracy's greatest virtues is its flexibility, but the changes about to be wrought by new communication technologies will stretch the adaptive abilities of western democracies to their limit.

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Caught in the net

Jan 23rd 2003
From The Economist print edition

Instead of undermining repressive regimes, the internet might strengthen them

IF THE internet will force difficult changes on democracies by handing power to individual citizens, it seems reasonable to believe that it will have a devastating impact on dictatorships. But it is not impossible that instead of undermining repressive regimes, the internet could become the most effective tool of social control that autocratic rulers have ever wielded.

New communication technologies have long been thought of as unequivocally on the side of political freedom. Authoritarian regimes invariably go to great lengths to control the flow of information, and are especially obsessed with communications between individuals. Surely, then, increasing flows of information will undermine the power of such regimes? Optimism about techno-liberation soared when western television and radio broadcasts were seen to play a role in bringing down the Berlin wall. “Technology will make it increasingly difficult for the state to control the information its people receive,” said Ronald Reagan soon after stepping down as America's president: “The Goliath of totalitarianism will be brought down by the David of the microchip.” Speaking ten years later, Bill Clinton argued that China's efforts to crack down on the internet were “like trying to nail Jell-O to the wall.” Most people agreed.

But so far the internet has not proved as subversive to authoritarian regimes as expected. A report published this month by the Carnegie Endowment for International Peace, “Open Networks, Closed Regimes: The Impact of the Internet on Authoritarian Rule”, by Shanthi Kalathil and Taylor Boas, looks at the internet in a range of countries from China to Saudi Arabia and concludes that the conventional wisdom is wrong: “The internet is not necessarily an insurmountable threat to authoritarian regimes.” The political impact of the internet varies from country to country, say the authors, and depends more on social or economic circumstances and the government's own policies than on the catalytic effects of the internet itself. In societies where the government holds all political power and is willing to crack down hard on any dissent, a mere connection to the outside world has not been enough to force change. “Rather than sounding the death knell for authoritarianism, the global diffusion of the internet presents both opportunity and challenge for authoritarian regimes,” they write.

We'll do without

Many autocratic regimes may choose to forgo the internet's benefits to maintain political control, and others may remain too poor for wide public access to be an issue. In Myanmar or Iraq, for example, access to the internet is so tightly controlled that the few people who are allowed to go online, mostly government officials, are easy to monitor. Cuba has used networking technologies in its health system,

through a national intranet, but has also succeeded so far in allowing a small selection of others to use the global web while denying access to the general public. Vietnam has followed a similar course.

And even where wider access has been allowed, the effects have sometimes been surprising. In Singapore, where a solid social consensus seems to support the restrictions of a semi-authoritarian regime, widespread internet usage has not encouraged the growth of an opposition. In Saudi Arabia, the authorities employ sophisticated filtering technologies purchased from western firms to block offensive web sites. This has been made easier by the extreme social conservatism of Saudi society. In a clever move, the country's official internet censors have asked for the public's help in deciding which sites to block. They receive some 500 suggestions a day, five times the number of requests they receive for unblocking sites (a list that may be just as useful to them).

But for other authoritarian countries the dilemma of the internet has been more acute. They are desperate to exploit its enormous economic potential. The biggest obstacle to development in poor countries is isolation from the world economy, and even the very poor sometimes benefit from an internet connection. Fishermen gain access to weather forecasts, farmers to the latest prices paid for produce in distant urban markets. Connecting a poor country could help its economy take off, a potent lure for any government. At the same time repressive regimes are determined to limit the internet's threat to their political control. Can they do both?

The most interesting example is China, which with 46m users already has the world's third-largest number of internet connections after the United States and Japan. Rapid growth in usage has been actively encouraged by the Chinese government, which sees electronic commerce as a main plank for modernising the economy and maintaining growth. At the same time it uses a panoply of techniques to curb the internet's political effects. Last September it attracted worldwide attention by blocking some access to Google and Altavista, two popular search engines, though after protests inside and outside China it partially restored the service. In addition to blocking sites, the Chinese government has deployed a range of other technical tools, from sophisticated monitoring of e-mail traffic and chatrooms to hacking attacks and viruses aimed at hostile websites. But even more effective has been its encouragement of self-censorship among internet service providers, content companies and users.

Although China has welcomed private investment into its telecoms infrastructure, it has carefully retained control over operating licences and over the system's backbone. This allows the authorities not only to use sophisticated monitoring techniques, but to punish any firms that step out of line. Most, including many big western firms, have been eager to comply. Likewise, by occasionally cracking down harshly on individuals, the authorities have intimidated most Chinese into staying within accepted boundaries on the internet. Chinese users never know who might be watching the way they use it, or when the axe might fall.

So far, this approach has been highly successful. The Falun Gong, the only direct challenger to the government's domination of public life in recent years, won a large following in the late 1990s by using e-mail and websites, but today the group's dwindling membership inside the country communicates mostly by payphone, which is harder to trace than e-mail.

The Chinese government's approach to the internet is a microcosm of its effort to liberalise the economy without relinquishing the Communist Party's monopoly of political power. Its attempt to control the internet's development will both mirror and feed back into political events. Future technological developments may play an important part, but are not likely to be the determining factor.

China's employment of advanced technologies to filter and monitor web usage has outraged many computer programmers in the West. These so-called “hacktivists” are combining hacker skills with political activism to fight what they see as a perversion of the internet's promise. The Chinese authorities are probably already working on counter-measures. This cat-and-mouse contest is likely to go on for years. With millions of programmers of its own, China is bound to get some home-grown hacktivism as well.

But the contest looks decidedly lopsided. On one side are small bands of political dissidents, human-rights activists and hackers; on the other stand not only authoritarian regimes but also western governments, who want to stay one step ahead of the hackers and are reluctant to support hacktivism even against dictatorships. They are supported by most of the commercial world, which wants to monitor and record web usage to make money, enforce copyrights, acquire customers, deliver new services and protect its own operations from malicious hacker attacks. American and European companies have fallen over each other in their eagerness to sell the latest surveillance gear and software to China and Saudi

Arabia.

Worryingly, the same technological trends that are so rapidly eroding privacy in the West could put powerful tools in the hands of repressive regimes. As more human interactions are conducted and recorded electronically, as the ability to analyse databases grows and as video and other offline surveillance technologies become cheaper and more effective, it will become ever easier for authoritarian governments to set up systems of widespread surveillance. George Orwell's Big Brother of “1984” might yet become a reality, a few decades later than he expected.

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Through a glass darkly

Jan 23rd 2003
From The Economist print edition

The biggest decisions about the internet's future will be political and social, not technological

FOR some readers, this survey may have suggested that the risks and uncertainties of the new internet-related technologies are too big to be worth incurring, and that the world should therefore choose to forgo their benefits. But that no longer appears to be an option. The technologies that have built the internet are racing ahead on many fronts, and are already too pervasive to stop in their tracks. However, that still leaves plenty of choices, many of which will require a new consensus to be built outside existing categories of social or political debate. The outcome will be determined by people, not technology.

Many of these choices will not be a matter for legislatures or courts, but will involve the informal renegotiation of interpersonal relations. This has already begun. For most people the convenience of e-mail, mobile phones and voicemail has proved irresistible, but many have also begun to feel the downside of being constantly in touch. Some feel obliged to respond to messages immediately. Others try to limit the expectations of their boss or family by taking longer to reply, or switching off. As it becomes easier to know where people are at any time, and to communicate with them, the burdens as well as the benefits of being “always on” will become more acute, and private bargains between workmates, friends, lovers, parents and children will have to be struck.

Similarly, the most potent antidote to the rapid erosion of personal privacy may prove to be not new laws but new rules of etiquette. As the volume of information in the public domain continues to grow, it may come to be seen as rude to do a web search about your neighbour or a casual acquaintance. Employers may find themselves competing with each other for the best workers with promises not to monitor their e-mail traffic or web-browsing habits, or by offering strict limits on the use of corporate surveillance cameras.

Where social norms fail, clashes over privacy and access to information will end up in the law courts, and new laws will be needed. This, in turn, will highlight one of the most important questions presented by the internet: in a networked world, what will be the nature of government power? The fact that the internet spans the world, and is indifferent to borders, squarely challenges the idea of geographically specific legal jurisdictions that has been the basis of the nation state. Already the web is in constant use not only by governments, companies, news media and law-abiding individuals but also by fraudsters, child pornographers and terrorists. As the growing power of electronic technology makes it possible to conduct more social interactions on a global network, the internet will force governments to decide whether they should act alone or together on a wide array of issues, from law enforcement to tax collection to the regulation of obscenity.

What governments can do

There appear to be three possible routes, and so far governments are travelling down all three of them simultaneously. The first route is to negotiate transnational laws and rules to govern the growing areas of life affected by a global web. This has worked well where there is already agreement about what the rules should be. For example, the use of e-mail, mobile phones and electronic transactions has made it easier, not harder, to hunt down terrorists such as those responsible for the September 11th attacks, and governments have had little trouble co-operating in gathering such evidence.

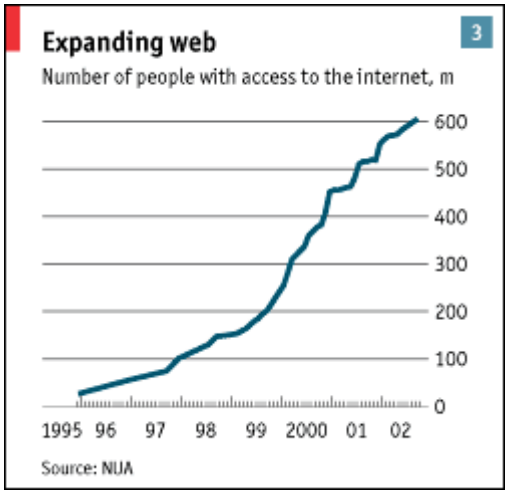
But where national sensitivities differ, international agreement can be hard or even impossible to reach, as the EU and the United States have already found in negotiations over privacy protection. Another notable example is the refusal of an American court in 2001 to enforce a French ruling against Yahoo! for allowing French browsers to view Nazi memorabilia on its online auction site. The courts are coming up against this sort of problem with increasing frequency. A group of record companies managed to shut down Napster for copyright infringement in 2002. But when they took another file-sharing service, Kazaa, to court late last year, they discovered that Sharman Networks, the distributor of its software, is incorporated in the South Pacific island of Vanuatu and managed from Australia; its computer servers are in Denmark; its source code is thought to be stored in Estonia; and its developers, who still control the underlying technology, live in the Netherlands. The service has 60m users in over 150 countries. Even if the American court decides against Kazaa, it may not be able to enforce its judgment.

A second route for governments is, in effect, to turn away from the idea of a global web and to build technological, legal and regulatory borders into the network itself. As described earlier, countries such as China and Saudi Arabia invest heavily in erecting barriers and monitoring web usage to exert political control over their populations. Private firms also employ such technology, but only to stay out of trouble. Last October a study by the Berkman Centre for Internet and Society at Harvard discovered that Google, an internet search engine, had blocked more than 100 racist and Nazi websites from its French and German versions to avoid legal liability. Filtering and barriers may grow as the cross-border nature of the internet brings it into increasing conflict with the enforcement of national laws.

Filtering and barriers may grow as the cross-border nature of the internet brings it into increasing conflict with the enforcement of national laws

The third route is for governments not to respond at all, either because they are flummoxed by the complexity of the task or because they believe that, as a matter of policy, it is better to leave well alone. This is what happened when the web unexpectedly took off in the 1990s, and to some extent governments remain uncertain. And yet they seem unlikely to remain paralysed indefinitely, or even to choose self-restraint as a deliberate policy, because by doing so they would be steadily undermining their own powers, not just internationally but domestically as well. That might well promote freedom and creativity, but it would also do the same for criminality and legal chaos.

Some observers think that the future of the internet society will be shaped not by governments but by technological decisions and the companies that take them. Mr Lessig has written two books arguing that “code”, the technical communication protocols of the internet and the structure of the web, is as effective as law in dictating what is possible and what is not. He is especially concerned that large companies which make these decisions to suit their own interests are pre-empting democratic debate. He is also worried about the lobbying power of the large software and entertainment companies when relevant laws are under discussion.



These are valid points. Technological decisions often have important legal and social implications, as do seemingly minor legal and regulatory changes. Most people glaze over when geeks debate which form of packet switching is best, or argue over the merits of placing the intelligence of a network at the centre or the edge. The possible effect of such decisions should, as Mr Lessig urges, be more carefully examined and widely discussed.

The best is yet to come

But Mr Lessig is being too pessimistic when he gives warning that future choices are being eliminated by

code. There is so much innovation still in progress that nothing will be set in stone for decades yet. The internet and all the communication technologies related to it will be re-engineered over and over again. These technical changes may influence social choices but, except at the extremes, they will not determine them. Instead, the application of these new technologies will come to reflect the balances which society strikes between freedom and stability, accessibility and privacy, private ownership and public goods, democracy and authority, global and local control. Far from dictating such choices, future versions of the internet will make them more urgent and inescapable.

The dream of John Perry Barlow and others that cyberspace would be free of such choices, a community entirely liberated from the lumbering governments of the tangible world, always seemed eccentric. With the benefit of hindsight, it can now be seen as an escapist fantasy made plausible only by the confusion that followed the startlingly rapid growth of the internet in its early days. The truth is that we all live in the internet society now, whether or not we spend any time online. The future will bring exciting, disorienting change as electronic communication reaches ever deeper into everyone's life. The prizes will be great. A more productive and safer society is possible. But things could also go nastily wrong.

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Jan 23rd 2003
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The author is grateful to the many people who generously gave him their time and assistance. An enormous amount of material has been published about the internet and its future development. The following books and articles were helpful in preparing this survey:

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Jan 23rd 2003
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The case for going private

Jan 23rd 2003
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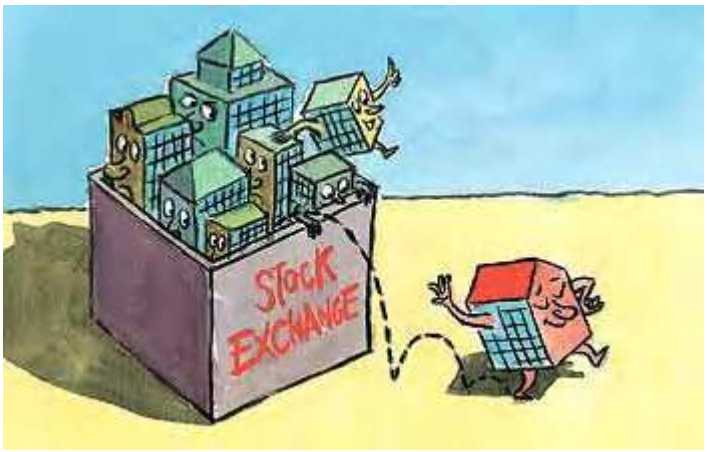

The battle for Safeway raises an old but important question: is it better to be a private company than a public one?

NOTHING in business beats the thrill of a good old-fashioned takeover battle. And the fight to win Safeway, Britain's fourth-largest supermarket chain, seems destined to become a classic. After Safeway's management agreed to a friendly merger for £2.6 billion ($4.2 billion) with a rival, Wm Morrison, on January 9th, no fewer than five other potential bidders have emerged, so far, and the firm now says it no longer recommends the original offer to shareholders. Journalists, bored by worthy stories about corporate governance, are cock-a-hoop, along with London's investment bankers. Some are even daring to hope that the exuberance over Safeway will be infectious, bringing about the return of those animal spirits whose absence from the executive floor was recently bemoaned by Jack Welch, former celebrity boss of General Electric.

Such hopes are premature, at best. But the bidding for Safeway may highlight a somewhat different trend in corporate ownership: the growing attraction of taking public companies private. Although four of the six firms said to be interested in buying Safeway are its publicly traded rivals—Wm Morrison, Wal-Mart (which owns Asda, Britain's third-biggest supermarket chain), J. Sainsbury (number two) and Tesco (one)—the other two want to take the firm private. One is Kohlberg Kravis Roberts (KKR), a private-equity firm that achieved notoriety in the late 1980s with its leveraged buy-out of RJR Nabisco, mythologised in “Barbarians at the Gate”. The other is Philip Green, a controversial British businessman who achieved notoriety in 1992 when institutional investors forced him to quit as boss of Amber Day, a publicly traded retailer, after its share price plunged, but who has since made a fortune as a private investor, buying up two once-quoted retail chains, BHS and Arcadia. Yet another private investor, Texas Pacific, may also be mulling a bid.

Although the number of public firms going private fell last year, along with other corporate capital-market activity such as initial public offerings (IPOs) and mergers and acquisitions (M&A), the drop from the peak has been much smaller than the drop in offerings and mergers. In Europe, for instance, the volume has ranged between *euro*10 billion ($11 billion) and *euro*14 billion in the past four years, and the number of deals between 20 and 45, says Bridgepoint Capital, a venture capitalist.

Moreover, whereas the bursting of the bubble is likely to depress demand for IPOs and mergers for years, it has probably made the case for going private stronger than it has been since the 1980s. In the 1990s, capital was available in effect free in the stockmarkets, and it was a foolish firm that did not get some by going public. Now, that capital has dried up. Many firms now trade at such depressed prices that it may be equally foolish to remain public.

And, whereas most of the firms that have gone private in the past few years have been relatively small, in recent months some bigger deals have taken place, and even bigger ones have been mooted. Alastair Gibbons, deputy chief executive of Bridgepoint, which has taken 11 firms private and is looking at several more, now sees ever larger firms going private. Increasingly, they are in continental Europe. And in Britain last year, Southern Water was taken private for £2.1 billion and Brake Brothers, a catering firm, followed for £600m. Tom Hunter, a wealthy investor, wants to take House of Fraser private. Rumours suggest that investors are also sniffing around the JJB Sports chain, Mothercare, Matalan, a fashion group, and even Boots, a chemists—all quoted.

In America, Dole Foods, a fruit giant, delisted after a $2.5 billion buy-out by its chairman last December. There have also been more private sales of bits of big companies, such as Diageo's recent sales of Burger King to Texas Pacific. In some cases, this reflects a need for firms to raise capital fast; in others, an attempt to raise their share price by becoming more focused. In either case, a private sale now makes more sense than an IPO. Robert Kindler, global head of M&A at J.P. Morgan, expects more of the same: “Private equity deals surged 64% in 2002, so I think we'll see a lot more going-private deals this year.”

Misery in the market

There are other good reasons to be private. After three years of falling share prices, and with fund managers and share analysts focusing on bigger, more fail-proof firms, many well-run, profitable firms trade cheaply, often below the book value of their assets. At such prices, a big reason for being quoted—the ability to raise capital—scarcely applies. Nor is there much chance of making an acquisition using the firm's shares as currency. Roger Carey took Saville Gordon, a property firm, private last August in a £500m buy-out after 35 years on the stockmarket: “We were exceeding on all fronts. We had great returns, tremendous growth, but investors were not listening—it was like talking to a brick wall. Our shares were at a 40% discount. It was totally demoralising,” he says.

According to Roberto Quarta, a partner at Clayton, Dubilier & Rice, “Managers come to us and say ‘it is wholly unfair. Compare our performance and our share price.’” Buy-out funds, by contrast, mostly take a long-term view, freeing firms from the pressure of quarterly profit targets. Better still, unlike the public markets, private investors, especially private equity funds, have money. Charles Milner, head of KPMG's private equity group, says that they are “flush with funds and are very actively looking at businesses”.

“Managers see going private as an opportunity to get rich”

Financial buyers are not only prepared to pay cash for deals. They will also reward the target firm's managers—often the existing, demoralised lot—that way. At a time of underwater stock options and complicated incentive plans for public bosses, cash has great attractions—a fact that Mr Green, the would-be Safeway buyer, insists helped him to win the enthusiastic backing of executives at Arcadia and BHS after he took control. Bridgepoint's Mr Gibbons puts it bluntly: “Managers see going private as an opportunity to get rich.”

Bosses of private firms also have greater control and face less tiresome scrutiny—something that will seem even more tempting as the latest round of corporate governance reforms take effect in public firms. Martin Lipton, an American corporate lawyer, says that going private can give managers the freedom to make hard strategic decisions, such as selling a failing division at a loss, that would be punished on the public markets. At the same time, the carrot of an ownership stake and the pressure of having to repay debt either to the banks or to a venture capitalist concentrates managers' minds on the job. That is why David Arculus, who once led the buy-out of Reed Elsevier's consumer-magazine arm IPC, calls taking firms private “the purest form of capitalism. It tests your mettle and drives you to superior performance.”

Freedom from interference clearly motivates many bosses who go private. Mr Green, who is scathing about Britain's latest corporate-governance sally, the Higgs report (see article), proudly declares: “We haven't anyone else to satisfy but the banks.” Institutional investors who once forced him out of Amber Day may be equally grateful for not having to oversee him.

And, as the baying for corporate blood intensifies, being private has another advantage—freedom from shareholder lawsuits. Mr Lipton estimates that liability-insurance costs for directors and officers in America have quadrupled in the past year.

True, removing firms from public scrutiny could increase their ability to engage in reckless or even fraudulent business practice. But at least that would hurt only professional financiers, not small

shareholders. Anyway, given the past two years, it is hard to argue that public companies have been models of probity either.

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Corporate governance

Thin on top

Jan 23rd 2003
From The Economist print edition

Britain tries to improve its boards

WITH three hefty reports on corporate governance in a decade, Britain cannot be accused of ignoring the subject. But last April the government asked Derek Higgs, a banker, to produce a fourth, on the role of non-executives. It appeared this week with a companion report by Sir Robert Smith, a businessman, on audit committees. Most of Mr Higgs's recommendations will be slotted into the combined code of corporate governance with which quoted firms must either comply or explain why not. They will make British corporate governance as coherent and transparent as any in the world.

Some of Mr Higgs's ideas match American ideas for better boards. He wants at least half of directors to be independent of the executives. (Now, fewer than 20% of British boards have such a majority, says Pension Investment Research Consultants.) He wants an annual evaluation of the board. At least one member of the audit committee should have “significant, recent and relevant” financial experience.

Other ideas show how differently the British and Americans view governance. Mr Higgs says that the roles of chairman and chief executive should be split (as they are on 95 of the FTSE 100 firms) and ex-chiefs should not move on to the chairman's seat. A majority of directors should be non-executives. But there should be strong executive representation. In America, the only executive on many boards is the chief executive.

More controversially, he wants a senior independent director to chair regular meetings of the non-executives (without the chairman's presence) and to be a conduit for grumpy shareholders. “Chief spy in the camp—the job from hell,” says Simon Bartholomew of Russell Reynolds, a headhunter. But Colin Mayer, of Oxford University, argues that the report's proposals will make non-executives more aware of their responsibilities and give them a channel to communicate directly with investors.

Headhunters will be the first beneficiaries of the report. The insistence that nobody should chair more than one big firm will step up the hunt, already hard, for chairmen. His call for more independents will boost the search for non-executives. This is at a time when the duties of non-executives and the boardroom risks are greater than ever. Mr Higgs wants non-executives to be paid well for good performance. But it may be hard to fill all those leather chairs quickly.

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Corporate lawyers

Whose side are they on?

Jan 23rd 2003 | NEW YORK
From The Economist print edition

American lawyers are appalled at the prospect of turning in their employers

OF ALL the controversial changes arising from America's new corporate-scandal-inspired Sarbanes-Oxley legislation, the one that lawyers like least is, yes, the one about lawyers. The Securities and Exchange Commission (SEC) is due to agree by January 26th the details of new rules requiring lawyers who learn of fraud or any breach of fiduciary duty at firms they work for to squeal until the breach is redressed, even if this means calling the SEC itself. Many corporate lawyers are aghast and fighting to soften the new rules.

Currently, under cover of attorney-client privilege, all manner of rotten information that passes before lawyers can be kept confidential. According to lawyers, this allows candour and, thus, appropriate advice. This privilege has been written into state ethical codes for attorneys. The shield protecting lawyers from liability for dubious corporate actions was reinforced by a 1994 Supreme Court decision exempting lawyers from being guilty of “aiding and abetting” corporate fraud and by the 1995 Private Securities Litigation Reform Act.

To critics, this undermined an already fragile ethical balance for lawyers, who, they believe, are quite willing to help firms to bury all sorts of horrors. Corporate attorneys may in theory represent the whole company, but inevitably become tools of their direct paymasters—to the potential detriment of the company's clients, shareholders and other employees.

However, not long ago, a small group of law professors asked the SEC to change the situation. They were advised instead to work through Congress. Their aim of forcing lawyers who learn about a corporate fraud to address it gained support from several prominent senators after Enron imploded, generating evidence suggesting that lawyers employed by the firm had endorsed dubious transactions.

Following Sarbanes-Oxley, and assuming the SEC is not lobbied into loopholing the new rules into nothingness, company lawyers will have to report any knowledge of illicit behaviour first to management and then, if that fails to get a proper response, to push the issue as far as the company's board and then to the SEC itself. In a proposal that is perhaps most at risk of falling foul of lawyerly lobbying, a lawyer would have the option of resigning, but, under a “noisy withdrawal” provision, the SEC would have to be informed, thus providing an invitation for an investigation.

Bizarrely, Sarbanes-Oxley requires these provisions to apply to any lawyer dealing with an American-registered company, anywhere. The SEC says that it would be responsible for any enforcement resulting from the rule. It can bring only civil charges; but realistically, once the muck is stirred up, it is hard to imagine that criminal prosecutors would let it settle.

The consequences, say critics, could be dire. They argue that under the new rule lawyers would inevitably become whistleblowers or cops, a position that could not possibly be good for their own business and, arguably, for their ability to be consulted on the grey areas of the law, where their advice can be crucial. It would also transform the role of the SEC, burdening it with a huge new area to supervise.

Proponents respond that the current rules have enabled lawyers to become legally protected accessories to crimes. That is unacceptable. But a better solution than Sarbanes-Oxley might have been simply to restore criminal liability for lawyers who are proved to have participated in a fraud. Meanwhile, whatever detailed rules the SEC agrees are almost certain to be challenged by the lawyers, who are not a group lacking in legal representation.

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Online music

Unexpected harmony

Jan 23rd 2003
From The Economist print edition

The music and computer industries make peace, but differences remain

Get article background

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Robbie sings while he is losing

THE music industry is in trouble, and it is in no doubt about the culprit: digital technology, which makes copying music too easy. Despite the fall of Napster, music can still be downloaded easily from internet file-swapping services. Most new PCs come fitted with CD-R drives, which can be used to transfer (or "burn") downloaded tracks on to CDs. According to new figures from Forrester, a consultancy, 27% of Americans and 13% of Europeans download music. No wonder sales of music fell by 5% in 2001 and by 9% in the first half of 2002, says the International Federation of the Phonographic Industry (IFPI), a trade group.

Speaking at a conference in Cannes last week, the IFPI's chairman, Jay Berman, blamed online piracy for the fact that in the past two years, only one album ("The Eminem Show") has sold more than 10m copies worldwide. Not everyone is upset: at the same event, Robbie Williams, a highly paid singer, said that music piracy is "great" and that "there is nothing anyone can do about it." Still, this week the industry won a legal victory against file-swapping in America, where a federal judge ordered Verizon, a phone company, to disclose the identity of a subscriber who is accused of swapping music files online.

The impact of online piracy is, however, rather more difficult to quantify than the IFPI would have you believe. The evidence can usually be interpreted in either direction, which suggests that the overall effect on sales is marginal. Some users of file-swapping services buy fewer CDs as a result, but some users buy more. Besides, piracy is not the only possible explanation for the slump in music sales. It could also reflect fiercer competition from DVDs and video games, the weak economy, or a loss of interest in manufactured pop acts from reality-TV shows. Rather than admit that it might be at fault, though, the industry prefers to blame piracy for its woes, and to call for stronger laws to protect its wares and to pursue pirates. This has brought it up against the computer industry.

A particular bone of contention was a bill, introduced last year by Senator Fritz Hollings, calling for a piracy-detection system to be built into all digital playback devices, including PCs. Computer-makers worry that they may have a government-mandated technology imposed upon them, increasing costs and stifling innovation. To the music industry, this reluctance is akin to condoning piracy. The two camps have been trading blows ever since. At one conference, Les Vadasz of Intel, the world's largest chip-maker, characterised the entertainment industry's relationship to the far larger computer industry as "like a pimple on the elephant's rear end".

So it came as something of a surprise when the music and computer industries announced a truce on January 14th. The Recording Industry Association of America, which represents the world's largest record companies, agreed on seven "policy principles" with the Business Software Alliance, a software-industry trade group, and the Computer Systems Policy Project, which represents leading hardware manufacturers including Dell, HP and IBM.

There was much waffle about meeting the needs and expectations of customers, engaging in constructive dialogue, and so on. But at the heart of the agreement is a compromise. The music industry will drop its support for compulsory anti-piracy technology; in return, the computer industry will drop its support for

legislation, such as that introduced by Congressman Rick Boucher, to clarify consumers' “fair use” rights over digital content.

But since neither piece of legislation was likely to get anywhere, observes Steve Kleynhans of Meta Group, a consultancy, neither side has really conceded anything. Manufacturers of consumer electronics were not involved in the agreement, and nor, more significantly, was the film industry. Its trade group, the Motion Picture Association of America, continues to call for government action, including compulsory technical measures if necessary, to clamp down on piracy. Lee Black, an analyst at Jupiter Research, says the new agreement could merely herald a replay of the Secure Digital Music Initiative, an attempt to get the music industry and hardware manufacturers to agree on a standard for secure online delivery, which ran into the sand in 2001.

The central problem, says Mr Kleynhans, remains unresolved: the question of fair use. At the moment, if you buy a CD, you can lend it to a friend, play it in your car, and listen to it on a portable player: the same disc will work on any playback device. Extending this ease of use to music delivered over the internet, however, is problematic, because the ability to transfer music from one device to another opens the door to piracy. But the alternative, which is to use “digital rights-management” (DRM) technology to “lock” each track to a particular device, infuriates consumers. While proponents of DRM claim that it merely helps to keep honest users honest, in fact, argues Cory Doctorow of the Electronic Frontier Foundation, a lobby group, it “keeps honest users in chains”.

All parties agree that the way forward is a system that allows music to be downloaded, but in a way that balances the prevention of piracy with convenience for users. The question is where to strike the balance. One extreme would force consumers to rent, rather than buy, music; the other extreme is rampant piracy. Neither is sustainable. With this month's agreement, the music industry and hardware manufacturers merely agreed to disagree. But ultimately they will have to do a deal. Whether that deal is in the consumer's best interests remains to be seen.

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Viacom

Karmazin's choice

Jan 23rd 2003
From The Economist print edition

A media mogul considers his options

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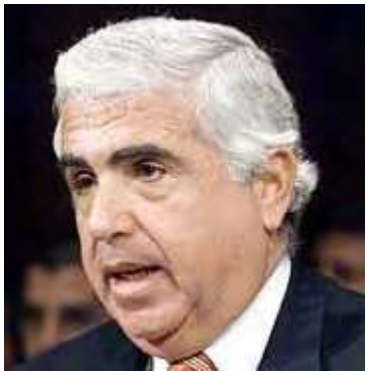

Will he stay or will he go?

OH, TO be a courted media mogul at a time of management turmoil in the industry. At each twist of the ongoing saga, one name repeatedly rings out as an all-purpose Mr Fix-it: Mel Karmazin, chief operating officer of Viacom. Disney's Michael Eisner is in trouble? Mr Karmazin is touted, as he was last autumn, as a possible successor. AOL Time Warner needs a fresh pair of hands at the top? How about Mr Karmazin? But will the razor-sharp former radio-advertising salesman really jump?

Ever since Sumner Redstone, Viacom's boss, bought CBS in 1999, the two men have had a prickly relationship. Under that deal, first proposed by Mr Karmazin, who had built CBS into a broadcasting, radio and advertising empire, Mr Redstone gave up operational control of all the divisions—which include Paramount Pictures, MTV, Nickelodeon and Blockbuster—to his new friend. Although he remained chairman and chief executive, Mr Redstone gave Mr Karmazin more powers than a chief operating officer usually gets. “It was a great leap of faith to invest him with such important responsibilities,” Mr Redstone recalls in his autobiography—though he probably had to make the leap in order to do the deal. Difficulties were inevitable. As he put it then: “Mel and I both covet control and there might be areas where we would collide.”

That contract expires at the end of this year. It is understood that Viacom wants a new one agreed within a couple of months. But Mr Redstone has been muttering to the press that he might not be ready to give up such powers second time around. And the 79-year-old has repeatedly refused to name Mr Karmazin as his successor. Hence the flutter of speculation about Mr Karmazin's future, not least by investors keen to eliminate the share-price discount that the uncertainty periodically creates.

The current rumour is that the tight-fisted broadcasting man beloved by Wall Street might be lured by AOL Time Warner's new chairman, Richard Parsons, into the chief executive's job. Mr Karmazin has the right sort of hands-on, hard-nosed management style, coupled with a record of keeping Viacom's operating performance ahead of the media pack during a severe advertising slump, to complement Mr Parson's diplomatic skills. The alternative? Hang on at Viacom in the hope of getting the top job—should it ever be free. “My bet is that he'll leave,” says one industry insider who knows Mr Karmazin well. “Redstone lives with the myth of invincibility. In his mind, he's not going away.”

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Iraq's oil

All about oil?

Jan 23rd 2003
From The Economist print edition

Why invading Iraq would not produce an oil bonanza for America

"IF WE are the occupying power," said Colin Powell, America's secretary of state, on January 22nd, Iraq's oil fields "will be held for the benefit of the Iraqi people." The Bush administration was examining different ways of managing the oil fields in the event of America invading Iraq, he said. Stung by criticism in much of the world that lust for oil is driving its enthusiasm for war, the Bush administration is trying to reassure sceptics that Iraqi oil would not be run only to suit America. Yet even without these assurances, it is far from certain that Iraqi oil could be the bonanza for America that its critics imagine.

These critics claim that any post-Saddam regime—which they presume would be a puppet of America—would move quickly to start pumping out vast quantities of oil. It would surely give in to American pressure to leave the OPEC cartel of price-fixers. Iraq's gushing wells would quickly undermine the cartel's grip, prices would collapse and OPEC might even be destroyed altogether—taking with it such unsavoury regimes as Saudi Arabia's.

Actually, even if Mr Powell's assurances turned out to be flimsier than they appear, there are good reasons to think Iraq would not become either an OPEC-slayer or America's private petrol station. Two new reports on the subject stress the constraints and challenges—not the easy pickings and limitless bounty—that Iraq's oil represents for America.

One report, by the Council on Foreign Relations (CFR) and the James Baker Institute of Rice University, argues that Iraq's oil is not the prize it seems from afar. Iraq has vast reserves, but its infrastructure is, in the words of Dutch experts who inspected it a few years ago, in "lamentable" condition. A decade of sanctions and under-investment have cut Iraq's output and done permanent damage.

In the short run, a war would further disrupt Iraqi production (especially if Saddam Hussein were to destroy oil wells): the result would be greater market power for OPEC and maybe $40-per-barrel crude, says Phil Verleger, an energy economist affiliated to the CFR. After that, even assuming that rebuilding the oil sector were a top priority for a new government, and oil revenues were immediately redirected for that purpose, the CFR-Baker study reckons that it would still take nearly a decade and up to $40 billion to revive Iraq's oil sector. That could lift Iraqi output to 4.2m-6m barrels per day, up from around 2.5m bpd today. However, it would still fall far short of Saudi Arabia's whopping output of over 8m bpd today. That is why no truly independent Iraqi government would ever leave OPEC to go for volume instead: the Saudis have so much more oil than anyone that they will always win a price war.

In the short run, a war would further disrupt Iraqi production, possibly leading to greater market power for OPEC and maybe $40-per-barrel crude

Besides, talk of a speedy revival of Iraq's oil sector may be too optimistic. A report from the Centre for Strategic and International Studies (CSIS) observes that, after a regime change, there would be many competing claims for money that would slow investment in oil: buying food, financing reconstruction, paying for "democracy building" and keeping the peace. Iraq also has debts of over $100 billion—not including war reparations due to Iran and Kuwait for Mr Hussein's past aggressions. However, this argument would be weaker if an occupying American government footed the bill for oil investment.

In an effort to curry favour with anybody ready to oppose UN sanctions, Mr Hussein has offered juicy chunks of Iraq's oil bounty to companies from Russia, China and France—countries whose geopolitical strategies are also tainted by oil. Whether America could tear up such contracts and "pre-contracts" is unclear. American and British firms, which have been prevented from bidding for such contracts, would lobby to have them scratched and retendered (along with other Iraqi oil contracts) in a contest in which

they have (at least) a level playing field. But to avoid a legal morass, the CFR-Baker report recommends the immediate creation of a UN dispute-resolution mechanism. Unless some way is found to provide a secure legal framework for oil concessions, much-needed foreign investment in Iraq could be delayed by years while the lawyers bicker.

In short, for all the accusations that America's war plans are motivated by the goal of cheaper oil, there would probably be no such prize, at least for many years. As the CFR-Baker report says: “There has been a great deal of wishful thinking about Iraqi oil.” It does not expect a bonanza.

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Wine industry mergers

Blended

Jan 23rd 2003
From The Economist print edition

The marriage of Australia's and America's wine industries

WINE producers in Europe have been reeling for a decade from the loss of traditional export markets to aggressive producers from the New World. Things may soon get worse. The Australian and American wine industries are now rapidly becoming one, forging big new wine firms that will enjoy huge advantages in marketing and distribution as the battle for the loyalties of the world's chardonnay-sippers and cabernet-guzzlers intensifies.

The latest proposed merger is between BRL Hardy of Australia and the Constellation Brands group of America, which is bidding $1.1 billion. The two firms would become the world's largest wine producer, eclipsing E. & J. Gallo of California. The BRL-Constellation deal is the latest of a series of tie-ups between Australian and American firms. Hitherto the most significant deal was the takeover in 2000 of Beringer Wine Estates of California by Foster's, an Australian firm which is famous for its eponymous beer but which now earns more from wine.

Although Constellation will be buying BRL Hardy, the boss of the new group is likely to be BRL Hardy's managing-director, Steve Millar. Australia is the driving force in the global wine industry. American winemakers have grown stout on their huge domestic market—but have not cracked the export game. Australia's smaller domestic market inspired its wine firms to become global earlier. Australian wine exports rose from A$180m ($140m) in 1991 to A$2.3 billion in 2002. The Aussies now out-sell the French in Britain. In the past two years they have broken through in America, where exports grew by 64% last year, and even, modestly, in continental Europe.

Merging with American firms makes sense for the Aussies as a way to build on their success in America. Firms such as Beringer and Constellation have established distribution networks that are crucial in a market in which wine is increasingly sold through supermarkets. But the deals are also attractive for the American firms. Their sales are flat at home and exports are the likeliest route to faster growth. The Australians have proven expertise in breaking into difficult European and Far Eastern markets.

Will Europe now be caught up in this wave of wine mergers? Unlikely. Australian and American wine firms tried to set up joint ventures in Europe in the past decade, but tended to be frustrated by the fragmentation of a market still dominated by small producers and co-operatives. BRL Hardy itself has had unhappy experiences in Sicily and southern France. America may produce a much tastier *cru*.

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Travel and tourism

Find bargain; will travel

Jan 23rd 2003
From The Economist print edition

Will nothing depress consumer demand for a night away from home?

THE travel industry should have been on a bad trip for the past 18 months: the economic slowdown, the rise in international terrorism and now the prospect of war in Iraq might each have persuaded travellers to stay at home. Yet the industry has, for the most part, kept its seats and beds remarkably full over the period. Many airlines are still losing money—on January 22nd American Airlines, the world's largest, announced a fourth-quarter loss of over $500m. But their load factors (passengers per flight) are near all-time highs. PKF, a specialist consultancy, says that room occupancy in both London and New York hotels last year averaged around 75%, an historically high figure.

December was particularly good. The Jumeirah hotels in Dubai had record occupancy levels over Christmas and the New Year. International passengers on American airlines were up by 15% on a year earlier (when figures were depressed after September 11th) and by almost 2% on the record figure for 2000, one of the best years that the industry has ever known.

Travel around Europe was also buoyant. BA's passenger numbers on its European flights in December matched its record in 2000, despite fierce competition from cut-price airlines such as easyJet and Ryanair. TUI, Europe's biggest tour operator, said this week that sales for its winter season are “at the same level as last year”. The Kempinski Ciragan hotel in Istanbul, for instance, laid off 50 people in November, only to wish it had kept them for the rush that came in December.

Of course, the picture is uneven. The tourist industry in Muslim Indonesia was already in trouble as Americans stayed at home after the attacks in September 2001, before the bombs in Bali last October virtually wiped it out. The island paradise had a miserable December, with hotel occupancy rates below 20%. The damage has now spread. Setyanto Santosa, chairman of Indonesia's Culture and Tourism Board, says that 45% of the small businesses in Djogjakarta, a city on Java renowned for its handicrafts, closed in the months following the bombing in Bali, which is a shop window for many goods made elsewhere.

Tourists are discriminating between places that they perceive as safe and those they do not. Vietnam and Hong Kong—in the safe category—had an excellent 2002. Highly influential in tourists' perceptions are travel reports issued by the American State Department and Britain's Foreign Office. The travel industry follows them closely, and ministers from host countries fly to Washington and London to try to persuade officials to change negative ones.

Tourists are discriminating between places that they perceive as safe and those they do not

On January 24th, the foreign minister of Trinidad and Tobago is due in London to complain about Britain's current travel advice on his oil-rich nation—that it is “one of a number of countries where there may be an increased terrorist threat”. The advice persuaded P&O cruise liners earlier this month to stop calling at Port of Spain.

The Foreign Office removed Indonesia from its blackest list on January 7th. Instead of advising British nationals “against all travel to the country”, it is now advising them “against all non-essential travel”—not yet opening the door to the sun, sea and sand seekers. But as one country leaves the blacklist, others are added: Yemen in November and Venezuela in December. Despite the November 28th attack on a hotel in Mombasa and the attempt to shoot down an Israeli aircraft leaving the city the same day, oddly Britain did not blacklist Kenya, destination of 80,000 British tourists last year. This contrasts with America's State Department, which is advising its citizens that “the threat to aircraft by terrorists using shoulder-fired missiles continues in Kenya, including Nairobi.”

Keeping volumes high came at a price. The special offers and discounted fares that persuaded consumers to sally forth and leave their fears at home have slashed margins and cashflow across the board.

The bargains are continuing. The tendency of holidaymakers to book late has become more pronounced in the past month or so, and most firms feel that consumers still need extra incentives. United Airlines has a two-for-one deal on transatlantic flights booked this month. In effect, it offers a London to New York return fare for £129 ($208) until the end of March. Claridge's, one of London's poshest hotels, is offering a double room for £179 a night until the end of February. The special deal at the comparable New York Plaza hotel ($285 a night) lasts until the end of March.

The industry's ability to sell fast-changing special offers has been helped enormously by the popularity of the internet. The Leading Hotels of the World group, an organisation of largely urban luxury hotels, says that its volume of online bookings last year was 208% higher than in 2001. Paul McManus, the group's boss, believes that within a year its sophisticated upmarket customers will be buying more rooms over the internet than by telephone.

PhoCusWright, an industry analyst, reckons that $6.3 billion of hotel sales were made online last year, half directly with hotels and half through agencies. Revenues at Travelocity, a big online agency, were up by 11% in the fourth quarter of last year. By contrast, Hotels.com, a big rival, saw its revenue (largely from commission on room sales) fall in the same period, due to “an unexpected drop in room rates”—ie, all those special offers.

The uncertainty over Iraq is making it fiendishly hard for the industry to plan for the future. Judging staff levels and costs is particularly difficult. TUI says “it is currently not possible to give a reliable outlook for operating profit in 2003.” Those who get it wrong during this period of suspended animation could give stronger firms opportunities for consolidation in this notoriously fragmented industry. For example, Kuoni, an upmarket Swiss travel firm, had a bad year in 2002 and its share price fell by over 50% in the past nine months. Last week, there were rumours that it was about to be taken over by TUI.

For wealthy westerners, travel is now an addiction. The past 18 months show that neither economic nor security threats can get them to kick the habit for anything but a very short period—especially if there are bargains to be had. Once Saddam is sorted, it will be time to pack a suitcase and be off again. Almost anywhere.

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Asian mobile telecoms

And then there were three

Jan 23rd 2003 | BEIJING AND LONDON
From The Economist print edition

The first of two articles on mobile telecoms in Asia looks at the future of the Chinese market; the second examines why India is so far behind

AP

An early adopter

WITH around 200m subscribers, or 20% of the world total, China is the largest market for mobile telephones. So China's choice will have a huge impact on the biggest conundrum currently facing the industry: what will be the main standard used by third-generation (3G) mobile telephones to offer such excitements as internet-browsing and video? When operators bought licences to run 3G networks, paying far too much (over $100 billion) for them, a single global standard still seemed a possibility. No more. Instead, there are two rival technologies: W-CDMA, championed by European firms, which is expected to become the dominant 3G standard, but has been delayed by technical problems; and CDMA2000, championed by Qualcomm, an American firm, whose technology is already used in South Korea, America and Japan.

Now, the big question is: which standard will China choose? Backers of both 3G standards, each with strong political support, have been furiously lobbying the Chinese government (which is expected to issue 3G licences this year) to bless their particular technology. To complicate matters further, however, a third contender has entered the field: China's home-grown 3G standard, called TD-SCDMA.

This new standard was derived from an earlier technology developed by Siemens, a German conglomerate. It was a candidate to become Europe's 3G standard, but lost out to W-CDMA. The China Academy of Telecommunications Technology, which has spent five years refining the standard in conjunction with both Siemens and Datang, a state-owned Chinese technology firm, then took it up.

Why might China like its own standard? Adopting TD-SCDMA would reduce its dependence on foreign vendors and technology, and level the playing field for domestic suppliers of network infrastructure and handsets. Choosing W-CDMA would mainly favour European vendors, who are most familiar with that technology, while choosing CDMA2000 would mainly favour American vendors. Choose TD-SCDMA, however, and the foreigners are back to square one, except for Siemens, which is spending *euro*50m ($54m) a year on the technology in an attempt to steal a march on its rivals. Tellingly, Motorola, an American equipment vendor, has announced that it has begun to develop TD-SCDMA technology too.

Another advantage of TD-SCDMA may be that the other two 3G technologies rely on intellectual property belonging to Qualcomm. Proponents of TD-SCDMA claim that their technology was developed independently. Thus they need not pay licence fees to Qualcomm, making TD-SCDMA equipment cheaper. Qualcomm disagrees. A lawsuit seems inevitable.

Fervent backers of TD-SCDMA believe it will emerge as a mainstream 3G standard in China, and possibly beyond. Klaus Ahlbeck of RTX Telecom, a Danish company that is developing TD-SCDMA technology, says he believes that China will try to push the technology both at home and in neighbouring countries. After all, the government says it wants China to become a net exporter of intellectual property.

However, others argue, as Connie Hsu, an analyst at Pyramid Research in Hong Kong, puts it, that “China would never go it alone—it doesn't like to be different from other leading markets.” One option would be for the Chinese government to bless more than one technology: both W-CDMA and TD-SCDMA, perhaps. The problem with this, notes Patrick Horgan, an analyst at APCO China in Beijing, is that China's two

mobile operators, China Mobile and China Unicom, are both partially privatised. If either one was forced to adopt TD-SCDMA, an unproven technology, its shares would fall.

Such sceptics believe that the likeliest outcome is that China Mobile will adopt W-CDMA, China Unicom will adopt CDMA2000, and that TD-SCDMA will take off only if the government issues additional licences to let other firms enter the market, one of which then opts to adopt the unproven technology. Gavin Patterson, an analyst at Baskerville, believes it is most likely that TD-SCDMA will be used by China Netcom and China Telecom, two fixed-line firms, to provide “wireless local-loop” access. This works much like domestic cordless telephones, but on a larger scale; it is cheaper than connecting homes with copper wires, but the handsets work only within a limited area.

So far, the Chinese government is prevaricating: when it will issue the 3G licences, whether it will mandate particular technologies and whether TD-SCDMA will be one of them, all remain unclear. Officials are closely monitoring 3G's progress in other countries. Much hinges on how quickly W-CDMA can overcome its teething problems. If the European standard continues to struggle as different vendors battle to get their equipment to work together smoothly, TD-SCDMA could start to seem increasingly attractive, particularly to China Mobile, which is currently leaning towards W-CDMA. Given the government's vagueness and foot-dragging on 3G, says Ms Hsu, there is even the possibility that China might be thinking about skipping 3G altogether and going straight to 4G—whatever that turns out to be.

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Asian mobile telecoms

The tortoise and the dragon

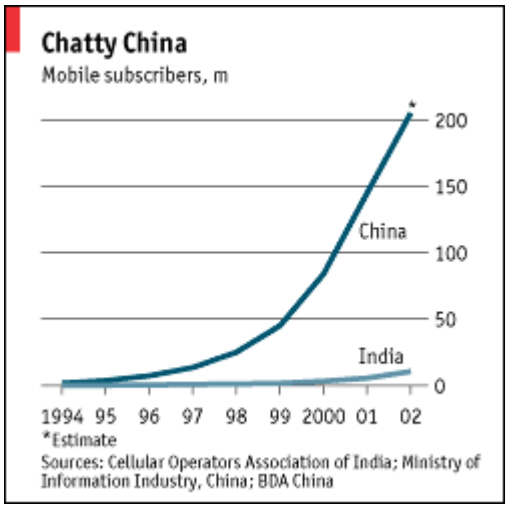
Jan 23rd 2003
From The Economist print edition

Why is India so far behind China?

CHINA and India have roughly the same population, of a billion or so. But when it comes to mobile telephones, there is no comparison between the two. In India, seven years after the launch of mobile-phone services, there are only 10m users. In China half that number—5m—sign up as new subscribers every month.

Geography and culture explain some of the difference. The concentration of economic activity in China's eastern coastal region gave its mobile operators big economies of scale, allowing lower prices. In China, telephones quickly came to be regarded as fashion items, something that has only recently happened in India.

But the main difference is regulation. India chose a licensing policy that divided the country into 22 regions, each with two licences to operate mobile networks. Bidding in multiple regions was restricted. This aimed to promote competition, but led to a fragmented market with a baffling array of operators, none of which achieved economies of scale. Limited spectrum also hurt service quality.



China fostered competition by creating a second state-owned operator, China Unicom, to fight the incumbent, China Mobile. Regulations favoured the upstart. China Unicom was, for example, allowed to undercut China Mobile by 10% in 1999. Prices fell, helping the market to grow. And there was plenty of spectrum.

In India, meanwhile, mobile operators found themselves embroiled in a series of legal wrangles with the government. The resulting uncertainty prompted many foreign operators to withdraw from the market altogether in the late 1990s. The Indian mobile operators then participated in a wave of consolidation, from which three dominant groups emerged: Bharti, Hutchison and IDEA (a joint venture between Birlas, AT&T and Tatas). But just as things were stabilising, the government tinkered with the rules again.

The latest fuss, which culminated in a ruling from India's Supreme Court last month, concerns the entrance into the mobile business of fixed-line telecoms firms offering “limited mobility” wireless services, with wireless coverage limited to a certain area. The Court allowed the launch of these services, with a caveat: the telecoms tribunal must re-examine a range of legal, regulatory and licensing issues.

Over the past two years, mobile operators have bitterly opposed limited-mobility services as they feel that the government's rules for the two services are different. As fixed-line firms have paid a lower licence fee than mobile firms, they may be able to lure away consumers with cheaper services. And mobile operators have to pay access charges for every call made from a mobile to a fixed-line network; the fixed-line operators do not.

One winner from the court ruling was Reliance Infocomm, the telecoms arm of the huge Reliance group. Within ten days of the ruling, it launched its limited-mobility service, at prices far lower than those offered by mobile operators.

To counter Reliance, the mobile firms slashed mobile-to-mobile long-distance rates. And they refused to

carry calls from fixed-line to mobile networks without payment of access charges. This was immediately opposed by the regulator, which ordered the mobile operators to carry the calls. But the state-owned fixed-line firm then started blocking calls to mobile operators, which led to tens of thousands of mobile users being cut off from fixed lines in Delhi last weekend. A truce has been brokered by the communications minister, who referred the question of access charges to the regulator. But the uncertainty remains, the battle between the fixed and mobile firms is far from over, and the contrast with China remains as striking as ever.

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Face value

The other Powell has a big year too

Jan 23rd 2003
From The Economist print edition

Michael Powell's four big decisions may make or break America's communications industries

AP

IN FRANCE, government officials are elite *énarques*; in Japan, bureaucrat-gods. The best that America's downtrodden, beaten-up bureaucrats can wish for is probably quiet obscurity. That, broadly, used to be the state of affairs at the Federal Communications Commission (FCC), a government regulator whose extraordinary reach spans telecoms, cable TV, the media and, increasingly, big chunks of the rest of the tech industry. Then came 2000, the telecoms crash and sudden, hostile attention. Technogurus such as George Gilder, a popular newsletter writer, pronounced the FCC to blame for the trillions of dollars that vanished in the telecoms gold rush of the late 1990s. Congress, which had written the 1996 act upon which the FCC's rule-making is based, ordered the regulator to fix the mess. So important was this task, wailed the pundits, that America's economic future was now, in effect, in the hands of incompetent bureaucrats.

Enter, in January 2001, Michael Powell, the genial son of Colin (America's war-hero secretary of state) and George Bush's choice to chair the FCC. At first, Mr Powell resisted analysis. For a start, there was that enigmatic, slightly insane grin on his publicity mugshots, which disturbed more than it revealed. Also unsettling was his obvious fascination with big ideas: Washington insiders were more accustomed to political wheeler-dealers such as Reed Hundt, a Democratic predecessor at the FCC. And what were Mr Powell's ideas anyway? He seemed to speak in eloquent riddles, whose circumlocutions left listeners elated, but somewhat dizzy. Stumped, the pundits wrote Mr Powell off as a crank, whose shaky command of his horribly complicated brief would all too soon end in tears.

The outlines of Mr Powell's ambitious and thoughtful agenda have begun to emerge

Two years later, the outlines of Mr Powell's ambitious and thoughtful agenda have begun to emerge and will be implemented this year through four big decisions. Next month, the FCC's five commissioners will vote on a crucial bit of policymaking that gets to the heart of what the Telecommunications Act of 1996 was trying to achieve. In the spring will come a broad overhaul of America's ancient media-ownership rules, which limit what media firms can own. Mr Powell will then decide the regulatory future of broadband—fast, always-on internet connections whose rapid spread is widely touted as the best way to lift America out of its investment slump. Ending Mr Powell's busy year will be a spot of creative thinking about how the government rations and manages the national airwaves. Together, say Mr Powell's staff, this amounts to the most important year for FCC policymaking that anyone can remember.

The first point that Mr Powell makes about his agenda is a practical one. As a matter of urgency, says Mr Powell, a trained lawyer who cut his teeth as a judge's clerk, the FCC's rules must comply with the 1996 act. This is not just stating the obvious. The act made ambitious attempts to inject competition into the “last mile” of telephone lines running into homes and businesses by forcing the local “Baby Bell” operating companies to lease these networks to competitors at discounted prices. Nearly seven years after the passage of the 1996 act, says Mr Powell, the FCC has neglected to demonstrate that its network-opening rules are, in fact, legal. On the contrary, the courts have twice thrown the FCC's rules out and told it to start again.

Likewise, the Baby Bells' broadband investments languish in a regulatory and legal limbo, as the FCC has not yet decided how to label—and hence regulate—them under the 1996 act. So decrepit are the FCC's media-ownership rules (the most youthful of them was written in 1978, before the internet was even a twinkle in Al Gore's eye) that the FCC has lost all four of its most recent legal challenges. This “legal

unrest", argues Mr Powell, has become a source of discontent, spawning debilitating litigation and inhibiting investment, especially in the telecoms industry.

Press 1 for deregulation

Mr Powell's critics say that behind these lawyerly arguments lurks a wild-eyed, free-market ideologue. Mr Powell clearly likes small government. His review of the media-ownership rules will have a deregulatory effect, as the FCC rejects or rewrites rules that it can no longer justify, such as the 1975 ban on owning a TV station and newspaper in the same market. He talks with enthusiasm about "market-led" regulations. He suggests, in his roundabout way, that in trying to prise open the last mile, the FCC has become too involved in costly micro-management that has yielded few real benefits to consumers. His review of these rules next month is likely to signal a gradual government retreat from the FCC's previous approach of subsidising new entrants. More importantly, he wants to exclude next-generation broadband investments from network-opening rules altogether.

But Mr Powell's real passion is clearly not ideology, but technology, on which he has an impressive grip. Take his review of the airwaves. Until now, the FCC has treated radio spectrum as scarce resource. But new wireless technologies suggest that, in the near future, radio signals will be able to navigate intelligently around each other in a wonderful free-for-all. Mr Powell has prodded his staff to think about the consequences.

Critics say that Mr Powell's telecoms policies will hand power back to the Baby Bells, setting the market back years. But the market looks nothing like it did in 1996. America's cable companies are already rolling out competitive local telephone services over digital networks. New wireless technologies proliferate, promising—within a handful of years—a second solid alternative to the Baby Bells' last miles. Already, the Baby Bells are losing market share and power. Their best days are probably behind them. Unusually for a regulator, Mr Powell seems to want, gradually, to write the FCC out of the game. For that, he deserves more respect than Americans usually shower on their benighted government officials.

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Investment banking

But which way is up?

Jan 23rd 2003 | NEW YORK
From The Economist print edition

Alamy

Wall Street is groping for a way out of trouble

ON A quiet Tuesday afternoon, Wall Street's bankers, brokers and bosses tuned in to watch Citigroup announce its results for 2002. Mainly, they wanted to see how a company battered by New York state's attorney-general, lousy capital markets, rising loan losses and imploding foreign operations could still earn $15.3 billion. Surely, they reasoned, if Citigroup could survive the past year, there was hope for everyone else.

Indeed, optimists can find hope amid the ruins. Citigroup's earnings, although bolstered by the bank's unique breadth of activities, was not out of line with the rest of the industry—if you exclude CSFB, a long-troubled, Swiss-owned investment bank, which lost SFr3.4 billion ($2.2 billion) last year. Returns on equity at Wall Street's biggest firms remain in the high single or low double digits. That may be the best response to hard times in the financial industry's history, says Diane Glossman, an analyst at UBS Warburg.

Better still, the investigation by New York's attorney-general, Eliot Spitzer, began with a bang but ended last month with a whimper. Citigroup contributed most to the settlement, $400m, but this was a mere sliver of the bank's revenues from telecom deals, which were at the heart of Mr Spitzer's inquiry. Historically minded optimists might even muse that the bear market is already a bit old.

Yet the mood in investment banks is far from celebratory. Mainly, this is because the Street's resilience has come at bankers' expense. Pay soaked up half of investment banks' revenues during the bull market. As revenues tumbled, so did compensation. Depending on the firm and the line of business, bonuses, which make up most of bankers' pay, fell by 40-60% in 2001 and then by another 10-50% last year, Ms Glossman estimates.

Wall Street's resilience has come at bankers' expense

Although a few businesses have puttered along, notably bond issuance and trading, those with the highest margins, mergers and initial public offerings, have been somnolent. For the first time since 1988, more money was withdrawn from equity mutual funds than was deposited. Because of low interest rates, even money markets saw demand fall. Few investment banks have found fresh sources of revenue other than investing their own money (a risky business) or lending it at interest (a business so unattractive that every commercial bank is trying to get out of it).

In an attempt to squeeze fees out of slow demand, many investment firms are rewrapping their products, slapping on higher fees, and hoping that clients do not notice. Customers who once bought

stocks and bonds, thus paying only a single commission per trade, are being encouraged to switch to packaged products with high, ongoing fees, such as in-house bond funds, and perhaps a second layer of charges for managing a portfolio of funds.

Investment firms are also eagerly selling high-cost hedge funds with stratospheric fees to investors of modest means. Previously, such investors would not have been allowed anywhere near such funds. They would do far better with a plain old mutual fund. All the investment firms' marketing efforts may do little more than refresh investors' suspicions that the industry is trying to fleece them.

Those suspicions may lead to expensive lawsuits in any case. As expected, Citigroup's results included a $1.3 billion charge for litigation, more than two-thirds of it for private suits. Robert Morgenthau, Manhattan's district attorney, continues to examine the bank's involvement with Enron. Within the next week or two, Mr Spitzer will release memos, e-mails and documents related to last month's settlement. If there was anything to his investigation, the disclosures should provide fresh embarrassment for Wall Street and possible fodder for civil suits.

There may still be worse to come. More litigation, so far only a twinkle in the eyes of the Securities and Exchange Commission and Mr Spitzer, may be on the way. True to past form, there have been no charges and such scant information as there is has leaked out through the press. A broad investigation into short-selling by hedge funds—a practice that is hated by the shorted companies but arguably keeps the market oiled—is said to be under way. More specifically, a hedge fund is under scrutiny for publishing potentially misleading research reports on the internet. A third investigation involves a Lehman Brothers analyst alleged to have passed the firm's research to her husband, who used it in his trading job at another hedge fund.

Even if the allegations are true, has any crime been committed? Hedge funds have no obvious duty to someone reading a free report on the internet. Lehman may have reason to be aggrieved about its opinions being lifted, but does the use of its research add up to insider trading? The closest precedent may be the prosecution in the 1980s of a *Wall Street Journal* reporter who leaked share tips prior to their publication in the paper's “Heard on the Street” column. The *Journal* had strict rules about the release of information and took a hard line. Lehman says the investigation does not involve the firm. The analyst is rumoured to have been suspended.

So nervous are investment banks about what regulators might one day see or think that they are giving their employees classes in e-mail etiquette

No one knows how far and for how long Mr Spitzer, not to mention civil litigants, will pursue the financial industry. Whatever the outcome, damage has been done. So nervous are investment banks about what regulators might one day see, or think they see, that they are giving their employees classes in e-mail etiquette (lesson one: write nothing). Internal comments are being faxed rather than e-mailed, thus leaving no trail. One fund manager says analysts call him on mobile phones, even to discuss public information, if they dare call him at all.

In the longer term, there is reason to question what investment banks will be able to offer clients if the way they disseminate information remains so constrained. Research departments, the focus of last month's settlement, are already under siege and conditions are likely to deteriorate in the months ahead. Hitherto, analysts have been paid out of three pots: retail broking, institutional sales and investment banking, which contributed perhaps half. This allowed some analysts to earn well over $1m a year, and maybe $20m. Now many will be fired; those that are not will earn at most $500,000. The best will probably join asset-management firms or hedge funds. Their job is, after all, to follow the most promising opportunities. If they are good at their jobs, they should be the first to know when Wall Street has lost its allure.

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Hedge funds

Big money

Jan 23rd 2003 | NEW YORK
From The Economist print edition

Once written off, macro hedge funds are back

Get article background

IN THE financial markets of the mid-1990s, there was no one more swashbuckling than a manager of a "macro" hedge fund, willing to bet fearlessly on any security anywhere. Then came the collapse of one such fund, Long-Term Capital Management, in 1998, and macro funds were denounced as a menace to the stability of the global financial system. By 2000, when George Soros and Julian Robertson, two of the best-known buccaneers, semi-retired, macro funds looked impossible to run profitably. Securities prices looked too volatile and currencies too stable.

Lately the few macro-fund managers able to ignore their obituaries have been among the financial industry's few successes. Data on hedge funds' returns are notoriously suspect, but James Hedges (sic), a fund-of-funds manager in Naples, Florida, believes macro funds made between 3% and 15% last year. Even the bottom of this range was far healthier than the 20% decline in the S& P 500 stockmarket index.

Nothing breeds popularity more than recent success. After two years of redemptions, a net $500m flowed into macro funds during 2002, according to Tremont, a fund-of-funds manager. A recent survey by Deutsche Bank says that about half of current investors in hedge funds expect to allocate more money to macro strategies.

Clearly, macro managers' confidence is rising. A typical hedge fund might charge investors 1% of assets per year plus 20% of profits—a good dollop even by the standards of the financial industry. But Caxton Associates, a large macro fund with a superb record, recently increased its fees to 3% of assets plus 30% of profits.

New managers are setting up shop, many of them refugees from the troubled world of investment banking such as Nick Rohatyn, a 19-year veteran of J.P. Morgan, who has started a fund specialising in emerging markets, and Barton Biggs, currently chief global strategist at Morgan Stanley. Sushil Wadhwani, until recently a member of the Bank of England's Monetary Policy Committee, is returning to the fray.

Two changes explain the return of the swashbucklers. Stockmarket valuations, which by 2000 made no sense to Mr Soros, are returning to something like rationality. And now the prices of a broad range of assets, including gold, oil and currencies, have become more volatile. There are fortunes to be made—and lost.

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American pensions

Broke

Jan 23rd 2003 | NEW YORK
From The Economist print edition

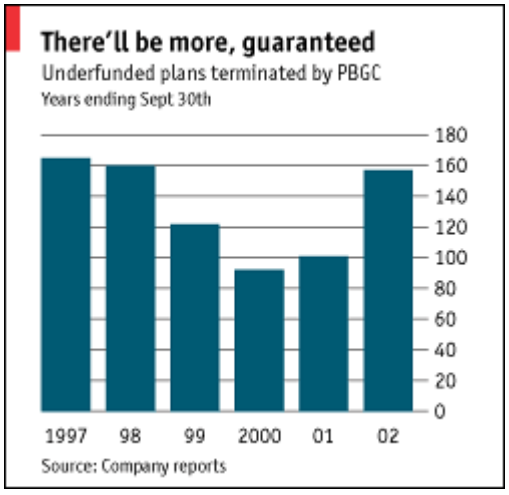
America's system of insuring private pension plans needs fixing

THE pension malaise in America worsens. Corporate pension-fund deficits have swollen to some $300 billion, weighing down earnings and forcing companies from General Motors to General Electric to find cash to make up the shortfalls. Meanwhile, the economy's continuing sluggishness is pushing ever more companies into bankruptcy and adding yet more billions to the pile of unpaid pension obligations.

Luckily for workers, help is at hand in the form of the Pension Benefit Guaranty Corporation (PBGC), the quasi-governmental agency charged with insuring the basic benefits of the 44m Americans enrolled in private, defined-benefit pension plans. Over the past year, the PBGC has mopped up the unfunded pension liabilities of a host of bankrupt firms, from Polaroid to LTV Steel. So maybe it is no surprise that the state-backed agency itself is on the brink of insolvency.

The tipping point will be the assumption of almost $5 billion of liabilities belonging to two bankrupt steelmakers, Bethlehem Steel and National Steel. The PBGC applied last month to take these plans over and is likely to do so, despite a challenge from National. The acquisition of the two firms earlier this month was made possible largely because the buyers believed that the PBGC, and not they, would pick up the pensions bill.

Oddly, the PBGC's difficulties have scarcely raised an eyebrow. “It's back to normality,” says a Treasury official, alluding to the deficits run by the agency for the first 21 years of its existence until 1995. In fact, although the agency is technically insolvent (ie, its liabilities exceed its assets), it probably has enough liquidity from insurance premiums, assets acquired when taking pension schemes over and investment income from its own portfolio to meet its obligations for many years to come. Should the money ever run out, the government would surely step in.



Indeed, the PBGC's net position is less of a problem than the pricing of its guarantees. Zvi Bodie, a finance professor at Boston University who specialises in pension funds, points out that the premium it charges companies to insure their pension schemes is not tied to risk.

It is unaffected by credit ratings or other evidence about a company's financial condition. So fundamentally healthy firms in effect subsidise the less sound. It is also unaffected by investment behaviour, creating an incentive to invest riskily. If all goes well, the schemes make handsome returns; if disaster strikes, the PBGC will foot the bill. In addition, firms that are short of cash have an incentive, when negotiating pay, to promise improved pensions instead of higher wages. Not only are the costs of the pay deal postponed; they may end up being borne by the PBGC.

The obvious solution, linking premiums to the riskiness of pension funds, is tricky. Doing so could force already wobbly companies into bankruptcy. And strong steel, airline and labour lobbies in Congress, which sets the PBGC's premiums, make any increases difficult. Workers and pensioners in the steel and airline industries, who account for fewer than 5% of participants in defined-benefit plans, have benefited from 70% of the agency's claims since 1974.

Mr Bodie suggests that restrictions on where pension funds put their money could strengthen the insurance system. Currently, estimates Morgan Stanley, more than half of companies' pension portfolios

consist of equities. This partially reflects the view that the riskiness of shares diminishes, the longer they are held; against that, says Mr Bodie, the potential severity of a shortfall in any one year increases with time. Ideally, he thinks, companies should fund their pension schemes entirely with bonds, a strategy adopted recently by Boots, a British retailer. That may be too restrictive a rule; but his arguments at least imply that firms should think twice before allocating large chunks of their pension funds to equities.

Meanwhile, there are two immediate concerns about the PBGC. First, unless America's bankruptcy wave comes to an unexpected halt, the demands on it are likely to rise. Second, the agency invests 35% of its own portfolio in the stockmarket. Yet the PBGC is likeliest to draw on its assets when the stockmarket is doing badly. Shouldn't it know better?

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Japanese banks

Worse and worse

Jan 23rd 2003 | TOKYO
From The Economist print edition

Japan's ailing banks seek much-needed new capital

DESPERATE times call for desperate measures. Woefully undercapitalised and under fresh pressure, since the appointment of a stricter banking regulator four months ago, to clean up their enormous bad loans, Japan's banks are trying to boost their capital any way they can.

Mizuho, the world's largest bank, demonstrated on January 21st how painful this will be. It said that doubling its bad-loan disposals, writing off large losses on equities and adhering to tougher criteria for capital would lead to bigger-than-expected losses in the year to March 31st. It now predicts a net loss of ¥2 trillion ($16.9 billion), the largest in Japanese corporate history and nine times more than it had forecast two months earlier.

Mizuho is now scrambling to raise ¥1 trillion of fresh capital, another record for a bank, by the end of March. It will probably resort to questionable but time-honoured practices, such as turning to borrowers or its equally weak buddies in the life insurance industry, which are themselves propped up by loans from the bank—even though the financial industry's regulator, the Financial Services Agency (FSA), now claims to frown upon such behaviour.

Mizuho might do better to copy Sumitomo Mitsui Financial Group (SMFG), another big, troubled bank, which has also been casting around for funds to cushion it against writing off its bad loans. On January 15th it said it would raise ¥150.3 billion, and so lift its capital-adequacy ratio by half a percentage point, by issuing convertible preferred shares to Goldman Sachs. If these were converted at current prices, Goldman would hold 7% of SMFG's shares, becoming its biggest shareholder. The deal is also seen as a bid by SMFG to restore its international credibility.

But it comes at a high price. The shares carry an annual 4.5% cash dividend after tax, or roughly 7% before tax. Much to the envy of its rivals, Goldman will also be indemnified by SMFG for losses of up to $2.1 billion in its own lending activities. And it will gain access to the Japanese bank's huge portfolio of distressed assets.

SMFG is also trying to build up capital in a more curious way, by bidding for a big stake in Aozora Bank, which was called Nippon Credit Bank until it was nationalised and sold to a consortium of investors in 2000. Softbank, an internet company with troubles of its own, has put its 49% stake in Aozora up for sale. A controlling stake would enable SMFG to consolidate Aozora's ¥700 billion of capital. Others have expressed interest, but the only serious rival is Cerberus, an American investment fund that already owns 11.5%.

The sale, which is expected to be finalised by the end of March, has become controversial. When Aozora was privatised, it was given a put option, which expires in September, allowing it to offload its bad debts on to the taxpayer. Unlike Shinsei, another once-nationalised bank now owned by Ripplewood Holdings, another American investment fund, Aozora has so far not used the option aggressively. Cerberus is likely to have fewer qualms. So many politicians want Aozora to go to SMFG, which could ill afford the negative publicity that exercising the option would bring. And if it did use it, it would have to write off its own loans to the same bad borrowers as Aozora.

If it saw off Cerberus, SMFG would win precious political capital. This could help it to stave off nationalisation should more of its loans turn sour. But Cerberus, because it is already a shareholder in Aozora, has right of first refusal: even if SMFG were to outbid it, Cerberus could snatch victory simply by matching its offer. Although the FSA could block a sale to Cerberus, few believe it would do so. In any case, SMFG risks overbidding if it wants to win. The bank is currently thought to be mulling a ¥100 billion

offer for the 49% stake, double Softbank's investment in 2000.

Whoever buys Softbank's stake, the future of Aozora, which has lots of bad loans and no clear strategy, looks bleak. Should SMFG win, Aozora would in time probably be absorbed into the bigger bank and in effect cease to exist. Its survival could also come under threat if Cerberus, which has no experience running a bank, wins but fails to come up with a successful long-term business plan. The government might then have to explain why it bailed out a bank with public money, only to have it disappear for a second time.

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Agricultural trade

Europe's meagre harvest

Jan 23rd 2003 | BRUSSELS AND WASHINGTON, DC
From The Economist print edition

The European Union is sending conflicting signals about its commitment to agricultural reform

AP

Fischler needs star quality

IT IS well known that the prospects for freeing farm trade, centrepiece of the Doha round of multilateral trade talks, depend largely on the European Union. The round can succeed only if Europe agrees to deep reductions of its huge, trade-distorting agricultural subsidies. And that can happen only if the EU's Common Agricultural Policy (CAP) is reformed. This week brought mixed signals.

The bad news was that France and Ireland (two of Europe's worst farm-subsidy addicts) blocked a Doha negotiating document prepared by officials at the European Commission. First released in December, this informal set of proposals had already been deemed too weak by the Americans and by other big agricultural exporters. But it was too strong for the French and Irish. On January 21st they refused to endorse the package and insisted it be discussed by the EU's foreign ministers on January 27th.

Unfortunately, the EU's inability to submit any formal proposals to the global negotiations is becoming a big problem. The internal deadlines set when the Doha round was launched in November 2001 look increasingly tenuous. There is supposed to be agreement by March 31st on the overall mechanism by which agricultural trade will be freed. America wants countries with high levels of support (such as those in Europe) to liberalise relatively more than others. The EU wants equal reductions by all.

So far, there are no signs of compromise. Instead the March deadline looks set to slip. Franz Fischler, the EU's agriculture commissioner, recently admitted as much, saying that September, when World Trade Organisation ministers meet in Mexico, was the real deadline. An American official sniffily called this the “Seattle prescription for success”, referring to the WTO's disastrous summit in 1999, which failed in large part because too many decisions were left to the last minute.

Yet Mr Fischler himself appears to be keen on change, at least by EU standards. On January 22nd he formally unveiled his proposals, first floated last summer, for reforming the CAP. Although his hands were tied by a Franco-German agreement last October to limit reform while capping spending, Mr Fischler has stuck with his biggest idea: to separate support for farmers from what they produce. Mr Fischler wants this separation to start in 2004, before ten new members from central and eastern Europe join the EU. That should boost the Doha round, because in principle it would reduce the trade-distorting nature of Europe's subsidies.

In other areas Mr Fischler has retreated. Last year he wanted to cut the amount of money paid directly to farmers and shift it into rural-development schemes instead. That has now been delayed. A plan to cap payments to large farms has been abandoned. Mr Fischler's efforts to tinker with the EU's absurd dairy regime are wimpish. He has put off reform of the Union's equally appalling sugar subsidies entirely.

In short, Mr Fischler's plan is less bold that it was last year, and much weaker than it should be. Nonetheless, it is progress. Mr Fischler himself says that, if the EU fails to come up with a plan for agricultural trade liberalisation, it “deserves to be called a political dwarf.” He wants agreement on his proposals by July, so that the EU can play its part in September. Dwarf or not, that will be a tall order.

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Secured lending

Slovak solution

Jan 23rd 2003
From The Economist print edition

Why Slovakia has the world's best rules on collateral

WHO would have imagined that Slovakia is at the forefront of reforms to simplify lending to companies that are short of cash? Its new rules governing how companies big and small can offer collateral to secure loans came into force on January 1st. In a few years, say people familiar with the reforms, Slovakia has set up a better system than those that have taken centuries to evolve in western countries.

Among rich countries, laws governing collateral have been reformed in America, Canada, Australia and New Zealand. But western European countries have made little effort to loosen the knot of laws and practices intended to secure lenders' rights over collateral. Complication and lack of clarity create inefficiency: small companies pay for this in terms of higher borrowing costs and poorer access to capital.

That may be bearable in the rich West, but not in poorer central Europe, where it has proved hard to develop strong small businesses. Poland, Hungary and the Czech Republic all have new rules. Slovakia, independent only since 1993, was desperate to catch up. Ivan Miklos, a reform-minded deputy prime minister, pushed the changes through, with help from the World Bank and the European Bank for Reconstruction and Development (EBRD).

Now Slovakia may be the one country in the world with a fully workable and consistent set of rules for secured transactions, coupled with a registry that allows every creditor to know exactly how much a company has pledged, and where it ranks in priority over other lenders. Of course, passing laws is one thing; implementing them is another. Slovakia ranks 52nd out of 102 countries in a corruption index compiled by Transparency International, an organisation in Berlin.

Nonetheless, Slovakia satisfies all ten of a list of principles drawn up by the EBRD to ensure the smooth working of secured transactions. Of these the most important are clear priority of title, low cost of enforcement and public registration of the secured asset. In European Union countries there are glaring gaps: for example, Germany, Austria and the Netherlands have no public registry. The Slovak law allows trademarks and intellectual property to be pledged as collateral, but few EU countries are so broad-minded.

Each EU country has a legacy of collateral law or practice, based on its own concept of property rights. In Germany, the lender must be sure that pledged machinery is clearly marked with his name, or else he might lose his claim on it in a bankruptcy. If pledged assets are kept in one room, he has to be sure they are not moved to another. The Slovak law spells things out simply: “A charge over a cow will include its calf up to the moment of birth.”

Multinational companies which lend across borders find the EU's national anomalies irksome and expensive, not least in legal fees. Yet there is no EU initiative to harmonise the rules on secured transactions, although change is proposed from time to time.

Slovakia's example is unlikely to colonise Europe—although Frédérique Dahan, a legal counsel at the EBRD, thinks it could be applied in Latin America. Some British experts would like Europe to move towards American practice, which has been updated regularly to accommodate new types of collateral. An American solution, however, is known to be anathema to the French and the Germans. A meeting of lawyers and academics in London last week discussed an overhaul along “European” lines, taking their cue from reforms in Poland, Lithuania and Slovakia.

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Inflation in post-communist Europe

Whipped

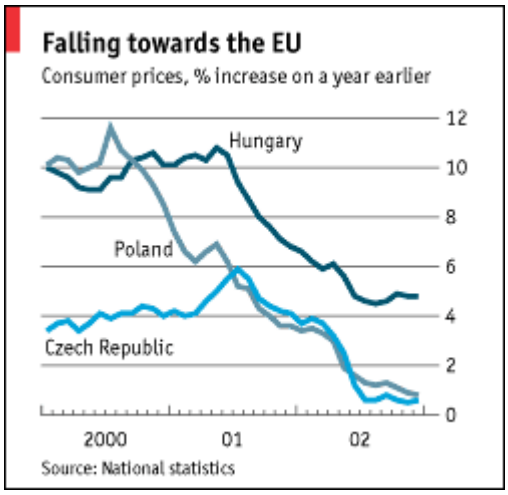
Jan 23rd 2003 | WARSAW
From The Economist print edition

Price stability has arrived in central and eastern Europe

UKRAINE knows the ravages of hyper-inflation. In the early 1990s reckless fiscal and monetary policies drove inflation to 10,000%, wrecking the country's first post-communist currency and wreaking enormous economic damage. But in the past three years GDP has grown by one-fifth. Inflation has been crushed. Last year prices fell by 0.6%.

Other ex-communist countries have similar stories. In Bulgaria inflation dropped from 1,000% in 1997, when it adopted a currency board to stabilise its currency, to just over 3% last year. Poland, a sufferer from hyper-inflation in 1990, still had double-digit inflation in 2000. Yet in the year to December consumer prices rose by only 0.8%. The Czech Republic's inflation rate is even lower, at 0.6%.

The main causes of falling inflation have been soaring currencies and tumbling prices for food and (until last year) oil, which account for a bigger share of the region's consumer-price indices than of those in richer countries. Inflows of speculative capital have pushed currencies up, and harvests have been strong.



The importance of seasonal and external influences on inflation, and uncertainty over the timing and size of government-regulated price increases have meant that central bankers have not been spared sleepless nights. Poland's central bank, in particular, has struggled to establish its credibility. It undershot its inflation target last year for the second year running, having overshot it in 1999 and 2000. In Hungary, where inflation is 4.8%, rampant by current standards, interest rates have been a few percentage points higher than in neighbouring countries. After the forint was pushed to the top of its permitted range against the euro, the central bank cut rates on January 15th.

It may be too soon to sound the death knell for inflation. As central and eastern European economies catch up with western ones, prices of non-tradable things—mainly services—ought in theory to rise more quickly than in the west. Vulnerability to external shocks, such as sharp movements in currencies or oil prices, could push inflation up as easily as down.

For all that, the home-grown risks of double-digit inflation have been sharply reduced, especially in the countries now on the threshold of the European Union. Although burgeoning budget deficits and political pressure on central banks pose a threat, the EU's Maastricht criteria for adopting the euro will help keep these in check. And policymakers deserve a pat on the back for lowering inflation, however fortuitously.

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Exchanges, clearing and settlement

All for one, or one for all

Jan 23rd 2003
From The Economist print edition

One-stop securities trading and processing may not be a good thing

YET another report by the great and good of the financial world on the clearing and settling of securities—the 15th since 1989—would not merit much attention, but for two things. First, it addresses new systemic concerns after the terrorist attacks of September 11th 2001, which exposed unforeseen weaknesses in securities settlement in New York. Second, it enters the debate raging in Europe over whether some exchanges are misusing a monopolistic processing infrastructure.

Regulators are pondering both issues. The report by the Group of Thirty (G30), an informal body of bankers and officials, proposes market-based solutions, rather than more regulation.

In the aftermath of September 11th, securities trading in New York was gridlocked because one clearing bank had operational problems, mainly caused by missing information about trades. Now New York's two main clearing banks are discussing a common real-time data pool. The G30's report calls for more such co-operation to ensure that the failure of one entity will not disrupt the entire financial system. But it recognises that not even layer upon layer of back-up systems will protect the markets from every disaster. “The contagion risk phenomenon is likely to increase further as the global system becomes more concentrated, with fewer and larger global firms and settlement entities,” it says.

Besides pondering how to guard against catastrophe, the G30's report offers 20 recommendations for greater efficiency, better risk management and fairer access to securities clearing and settlement. These are the nuts and bolts of securities dealing: clearing the trade through a central counterparty, and then ensuring that the securities are successfully transferred from the account of the seller to the account of the buyer, usually at a central securities depository.

Ideally there should be easy communication between exchanges, clearing houses and depositories, even across national borders—called “inter-operability”—to give users a free choice where they clear and settle their trades. In practice the most efficient and cheapest communication is usually within national borders, which gives national clearing and settlement systems a quasi-monopolistic advantage. Here the G30 sees a problem. There may be, it thinks, a possible conflict between private ownership—which seeks profits for shareholders—and the provision of the most efficient and accessible service for users. “Open access and inter-operability may not be compatible with profit maximisation,” it suggests. Mutual ownership by users apparently does not raise the same concerns.

The report picks out Deutsche Börse, operator of the Frankfurt stock exchange, as a vertically integrated structure combining an exchange with clearing and settlement under single, for-profit ownership. It questions whether that serves users as well as a structure that offers competition at every level. One remedy, it suggests, is for users and other stakeholders to be represented on the for-profit company's board. Monopoly tendencies can be balanced by watchful competition authorities, the report says.

This is grist for the mutual, user-owned entities in Europe, such as the London Clearing House (LCH) and Euroclear, the Brussels-based securities depository. But as integration of exchanges continues, the user-owned element will diminish—unless regulators intervene. Euronext, the Brussels-Paris-Amsterdam exchange, is for-profit and shareholder-owned. It also owns Clearnet, a clearing house. A merger between Clearnet and LCH would make sense because LCH clears trades for Euronext.liffe, the London futures exchange, which is owned by Euronext. But the merger of a mutual with a for-profit company is fraught with difficulty.

Such realities may make the G30 report little more than a wish-list to add to 14 others. However, the European Commission should be interested. It is about to pronounce on two relevant issues. One is

whether new regulation is needed to harmonise clearing and settlement in Europe. Frits Bolkestein, the commissioner for the single European market, will decide this on the basis of one more report, due by the end of March. The other is whether integrated exchanges, such as Deutsche Börse and Euronext, are anti-competitive. Mario Monti, the competition commissioner, is expected to say soon whether they have a case to answer.

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Offshore savings

The taxman cometh

Jan 23rd 2003 | BRUSSELS
From The Economist print edition

An end to tax-free saving for many Europeans

TIME to close that bank account in Jersey or Luxembourg. An unexpected agreement by European Union finance ministers in Brussels on January 21st will come as a nasty shock to the thousands, perhaps millions, of Europeans who have squirrelled away their savings in offshore accounts, avoiding tax on the interest. After ten years of haggling, EU members have struck a deal that will close tax havens all across Europe.

Under the deal all EU countries will either exchange information automatically with each other on savings accounts held by non-residents, or levy a withholding tax. The EU is close to concluding similar deals with other potential tax havens outside the Union, notably Switzerland.

The amounts of money involved are large. Germans alone are thought to have more than *euro*300 billion ($320 billion) stashed in offshore accounts. The implications for the financial industry in places like the Channel Islands and Luxembourg are commensurately serious. Luxembourg has the highest GDP per head of any EU country, but almost 40% of its GDP is linked to the financial-services industry, which has profited from the country's tradition of banking secrecy.

The importance of banking secrecy to Luxembourg, Austria and Belgium—and the complexities of the Eurobond market in the City of London—made it difficult to cut a deal. In 2001 Britain made financial institutions dealing in Eurobonds pass client information to its tax authorities, and the banks will now be obliged to do the same with other EU countries.

An EU-wide deal was made possible when Britain dropped its insistence that Luxembourg, Austria and Belgium should also exchange information as a matter of course. These countries will, however, have to impose a withholding tax on all savings interest that will rise in stages from 15% in 2004 to 35% in 2010. These three countries have also agreed to join the information-exchange system in the unlikely event that the EU can persuade Switzerland to abandon banking secrecy. The Swiss, although clinging to bank secrecy, have also agreed to levy a withholding tax on the savings of EU residents and to share the proceeds with the EU.

What of other potential tax havens? Brussels officials say that existing arrangements with tax authorities in America already allow information to be exchanged in cases of suspected tax evasion. Now that Switzerland has fallen into line, it is assumed that Monaco, Andorra, San Marino and Liechtenstein will be obliged to strike similar deals with the EU. European tax-evaders will have to start looking farther afield. Anyone for Asia?

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Economics focus

The price of profligacy

Jan 23rd 2003
From The Economist print edition

Do bigger budget deficits cause higher interest rates?

MITCH DANIELS, the top budget man in the Bush administration, last week acknowledged what private economists have known for months: that America has "returned to an era of deficits in the nation's public finances". Only two years ago, Mr Daniels was touting a projected ten-year budget surplus of more than $5 trillion as proof that America could easily afford a big tax cut. Now he expects deficits of between $200 billion and $300 billion (2-3% of GDP) over the next couple of years and modest spills of red ink "for the foreseeable future". What is more, these deficits exclude both the cost of a war in Iraq and President Bush's planned $670 billion tax cut.

No one disputes that the speed of America's fiscal deterioration has been dramatic. But is it a cause for concern? A fierce political debate is raging. Democrats (and many Republican fiscal hawks) worry that rising budget deficits will harm the economy by reducing total national saving and pushing up interest rates. Just as the shift to budget surpluses in the 1990s helped to reduce interest rates and boost corporate investment, they argue, so the return to deficits will do the reverse.

Nonsense, say the administration and its allies. Mr Daniels claims there is no reason to "hyperventilate" about budget deficits. The vice-president, Dick Cheney, argues that there is no evidence that interest rates move "in lockstep" with deficits. Other conservative commentators dismiss the idea that deficits affect interest rates as "Rubinomics" (after Robert Rubin, Bill Clinton's treasury secretary). The evidence, they claim, has never supported this crackpot idea.

The foundations of Rubinomics

In fact, Rubinomics is well grounded in economic theory. Few economists deny that, other things equal, a higher long-run budget deficit—or a smaller surplus—reduces national saving. This could be avoided only if larger deficits were fully offset by higher saving in the private sector, as households, recognising that deficits today meant higher taxes tomorrow, saved more to make up for the government's profligacy. In practice, there are few signs that savers are so far-sighted.

It is probable, then, that total saving will fall. This implies a higher interest rate as the government competes with firms for limited investment funds. This effect is muted when a country has access to foreign capital, because the budget deficit can be financed from abroad. But even in a global capital market, economic theory suggests that a bigger deficit in a large economy, such as America, would push up global interest rates.

At issue, however, is by how much. The political slanging-match in Washington is not about whether deficits could raise interest rates in theory, but whether they do so significantly in fact. Those sceptical of Rubinomics point out that deficits were tame in the 1970s, while interest rates soared. Interest rates fell in the 1980s, while deficits ballooned. And in the past two years long-term interest rates have fallen as the budget outlook has darkened. These commentators also note that the formal econometric evidence is inconclusive: plenty of studies find a statistical link between interest rates and deficits; plenty find none.

Quite right. It is hard to disentangle the effect of changes in today's budget deficit from other factors affecting interest rates. As well as fiscal policy, monetary policy and the economic weather play a role. During the past couple of years, a weaker economy and looser monetary policy have probably pushed long-term interest rates down, outweighing any impact from bigger deficits. On top of this, it is not enough simply to look at the effect of today's budget deficit (as many studies do). Investors'

expectations about future deficits are likely to influence long-term interest rates. So they should also be estimated and taken into account.

According to a new paper* by William Gale and Peter Orszag, two economists at the Brookings Institution, the evidence that deficits affect interest rates becomes clearer once a measure of expected future deficits is included. Mr Gale and Mr Orszag sifted through 58 econometric studies. At first sight the sceptics are right: the evidence is inconclusive. Fewer than half of the studies (28) found that higher deficits increased interest rates significantly. Nineteen studies found no significant effect and 11 had mixed results.

However, Mr Gale and Mr Orszag argue that only 17 of these studies included a careful measure of expected future deficits. No fewer than 12 of these found a significant relationship between deficits and interest rates. The authors conclude that a projected rise in the budget deficit of 1% of GDP raises long-term interest rates by 0.4 to 0.6 percentage points.

These results are similar to the numbers built into many macroeconomic forecasting models used by official and private-sector organisations (including the Federal Reserve and the IMF). They all assume that there is a connection between changes in budget deficits and long-term interest rates. On average, they suggest that long-term rates would rise by half a percentage point after one year and a full point after ten years if America's budget deficit rose by 1% of GDP.

This paper will not settle the debate in Washington, not least because Mr Gale and Mr Orszag are both prominent Democrats. Indeed, their work has already been dismissed as partisan politicking on the *Wall Street Journal*'s editorial page and elsewhere. That is a pity. The paper may have flaws, but it does attempt to re-examine the evidence and so deserves serious discussion. Unfortunately, in Washington today the argument over whether deficits affect interest rates has more to do with ideology than with economics.

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* "The Economic Effects of Long-Term Fiscal Discipline"

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Correction: Chicago Mercantile Exchange

Jan 23rd 2003
From The Economist print edition

In an article in our issue of January 18th we said that the Chicago Mercantile Exchange was mutually owned. In fact it demutualised in 2000. Sorry.

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Palaeontology

Dig this

Jan 23rd 2003 | CRAWFORD, NEBRASKA, AND HILL CITY, SOUTH DAKOTA
From The Economist print edition

Reuters

Private collectors and the government are arguing over the right to collect fossils

EVERYONE loves dinosaurs—maybe even a little too much. In the American west, where massive, fossilised skeletons often lurk beneath the badlands, the remains of dinosaurs and other vertebrates have become the subject of often-bitter struggles between scholars and commercial collectors. Concerns about animal fossils have historically taken a back seat to discoveries involving human remains, such as those of Kennewick Man. This month, a court ruling granted scientists access to this skeleton—the subject of a bitter six-year court dispute. Now, though, animal fossils are drawing attention too.

For decades, the poaching of fossils barely registered in the minds of law-enforcement officers. But that changed in the 1990s. Fed by “Jurassic Park” and the growth of internet auction houses such as eBay, the previously sleepy market for fossils jolted to life, both in America and overseas.

Complicating matters further was the tortured history of “Sue”. Sue was the most complete *Tyrannosaurus rex* skeleton ever unearthed. The Black Hills Institute, a private palaeontological organisation that discovered her in 1990 in South Dakota, intended to make the skeleton the centrepiece of a museum it planned to build in Hill City. Instead, Sue became the subject of a four-way custody battle between the institute, the federal government, an Indian tribe and a private landowner. Over the course of several years, the institute lost control of Sue. Peter Larson, the institute's founder, spent the better part of two years in jail for charges tangentially related to the discovery. And a court awarded the skeleton to the landowner, who promptly auctioned it off to the highest bidder. In 1997, Chicago's Field Museum of Natural History bought Sue for $7.6m, thus stoking (probably unjustifiably) lottery-style dreams of amateur fossil hunters.

So Sue me

The tug-of-war over Sue put the battle over fossils in stark relief. According to long-standing federal regulations, researchers affiliated with a university or museum are allowed to dig for fossils on federal lands, as long as they get a permit in advance. Everyone else—from families going on a weekend outing to skilled amateurs who sell fossils to museums or private collectors—must content themselves with digging on private land, with the permission of the owner.

Many private collectors resent these restrictions. They say that such barriers benefit a clique of scholars

at the expense of the fossils themselves. With millions of hectares of federal land largely unexplored, fossils are weathering away faster than legal diggers can recover them. The collectors also argue that this clique has exaggerated the scope of the black market in fossils in order to crack down on competition from collectors such as Mr Larson, even though many museums rely on commercial operators to supply them with fossils. Tensions between the two camps have increased, exacerbated by anti-federal sentiment. To many in the west, Mr Larson is now a folk hero.

Supporters of the crackdown, however, counter that they have valid reasons for keeping diggers on a tight leash. Federal land belongs to all Americans. As such, the government is charged with ensuring that important fossil specimens can be enjoyed by the general public, which means putting them into institutional hands, not private cupboards. Equally important, unregulated digs could remove fossils from their geological context, leaching them of almost all scientific value.

Almost everyone agrees that illicit digging occurs on public lands. Policemen from a variety of agencies in the west say that they see between three and 30 cases a year, and much activity doubtless goes undetected. Less clear is exactly who is doing the digging. Some trespassers appear to be relatively sophisticated. Officials tell of commercial operations that have sought to obtain federal permits under bogus museum names. Other lawbreakers have been known to steal fossils from legal dig-sites just hours after they had been dug up.

Some perpetrators, though, appear to be complete novices. “A lot of people come up to us and say, ‘Look what I found!'” said Price Heiner, an interpretative specialist at the Oglala National Grassland, a 94,000 acre (38,000 hectare) site near Crawford, Nebraska. “They clearly don't know it's an offence.” Given the vast area and the small police forces present on federal land, violators are usually tripped up by informants. In more complicated cases, officers may plant hidden cameras to catch poachers in the act. Several times, as with Mr Larson, prosecutors have gone after “big fish” in order to send a message—a strategy that rankles with many collectors. But more commonly, violators do not face prison. The usual punishment is a modest fine and an order to restore the dig site to its original condition.

Still, the crackdown seems to have had an effect. Most collectors say that they have begun to search through land titles more intensively before digging, since murkiness about land ownership deepened the legal quagmire over Sue.

Some collectors propose a middle ground. Institutions might subcontract their federal digging rights to regulated, for-profit collectors. Anything found that had scientific value would be set aside for museums or educational purposes, while more pedestrian items could be sold, with a royalty from every sale going to the Treasury. But Brent Breithaupt, director of the University of Wyoming's geological museum, said that a system much like this one has been used for years for state lands in Wyoming—and has regularly been abused. “It always seemed odd that the rare things on the market always came from the private quarries and the common things came from the state quarries.”

Even if those kinks could be straightened out, fossil collectors are not holding their breath. For now, the prevailing federal strategy seems to be criminal charges for serious violators and education for visitors who seem to know no better. Back at the Oglala National Grassland, Mr Heiner is now putting signs up, explaining the law, in obvious places such as trailheads. He adds, “Whenever we do interpretative fossil events for kids, we always show them fossils and say that if they see one, they should not pick it up.”

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Feathered dinosaurs

Four wings good

Jan 23rd 2003
From The Economist print edition

Chinese scientists have found a four-winged, feathered dinosaur

IT IS not always the biggest dinosaurs, such as *Tyrannosaurus rex*, that are the most exciting. This week sees the announcement of a 77cm fossil dinosaur find that has, remarkably, four feathered wings. It was discovered by a group headed by Xu Xing of the Chinese Academy of Sciences, and is described this week in the journal *Nature*.

Dr Xu's team found two fossils of a new species that they named *Microraptor gui*, in the Liaoning province of China, about 300 kilometres north-east of Beijing. *Microraptor* is a theropod dinosaur, and a close relative to the velociraptor that was made famous by the film “Jurassic Park”. Its feathers have an asymmetrical shape very similar to modern bird feathers. Dr Xu says that *Microraptor's* feathers would have allowed it to glide through the air.

Because the dinosaur's feathers go all the way down to the bottom of *Microraptor*'s legs, the researchers believe that it did not live on land. Running would have been difficult for an animal that was dragging its leg feathers on the ground. And dirt-covered feathers would also have made flying impossible.

As no one has yet worked out a way in which hind wings could be used for flapping in flight (and it is certainly hard to imagine how a bird with four wings would actually fly) researchers think that *Microraptor* must have been a tree-dweller that could glide.

Dr Xu supposes that it, or a similar four-winged dinosaur, might be an intermediate stage between earlier theropods that could not fly at all and *Archeopteryx*, a theropod that is thought to have been able to fly and is also the earliest identified bird species. *Archeopteryx*, like modern birds, had only two wings; Dr Xu guesses that the rear wings atrophied as bird ancestors moved from gliding to fully-fledged flight.

This gives ammunition to adherents of the arboreal school of thought, who hold that powered flight developed from gliding. The competing school holds that flight evolved on the ground, as some sort of powered running. Last week, researchers reported that partridges could run up steep hills more easily if they flapped their wings. This provides an evolutionary advantage as an intermediate step to flight, supporting the running school of thought.

While Dr Xu's results seem to be a stroke in favour of the arboreal school, a note of caution is in order. The last time such a fossil find was announced, in the October 1999 issue of *National Geographic*, it turned out to be a falsified specimen—the head and body of a primitive bird had been glued to the legs and tail of a theropod. But since Dr Xu and his collaborators were those who uncovered the hoax, there is good reason to believe that some dinosaurs had feathers.

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Chemistry

Gonna make you a star

Jan 23rd 2003
From The Economist print edition

How to grow small components

DIRK VOLKMER likes to think small. At the University of Bielefeld, in Germany, where he works as a researcher, he is looking forward to the day when scientists can reliably build robots and electromechanical systems on a microscopic scale—for use in everything from computing to medicine. The problem, he says, is that conventional manufacturing techniques are still far too clumsy to build many of the necessary microscopic components. Now, he and his colleagues are taking their inspiration from tiny marine organisms, the radiolaria, and their exquisitely structured siliceous skeletons. Their work is described in the January edition of the journal *Angewandte Chemie*.

The team realised that these tough little critters are extraordinary chemical conjurers that can turn the main source of silica in salt water, silicic acid, into a myriad of solid shapes and structures. By emulating radiolaria and by mixing the right ingredients, they hope to be able to create micro-components in the test-tube.

It is still not well understood how biomineralising organisms such as the radiolaria make their silica casings but the team has enough clues to start work. Its members have already found that they can copy the sophisticated processes by which radiolaria form their intricate shells, and have made some spiky silica structures that resemble radiolaria casings.

To make their mock shells, the researchers used a cocktail of soapy surfactant molecules to produce minute but stable oil droplets that could be emulsified into a water-based solution. The oil droplets contain a small amount of a metal oxide that acts as a precursor for the reaction. As soon as the droplets come into contact with water they begin to link together to form chains, which build up into a solid metal oxide coating on the oil droplet.

The researchers used video microscopy to see what happens as the metal oxide diffuses to the surface of the oil droplet. They were startled to see star-shaped mineralised shells, about 80 micrometers in size, forming from the originally smooth interface between the oil and water, as the metal oxide crystallises out of the mixture. The reaction is disarmingly simple and, says Dr Volkmer, is the first approach that truly mimics biology.

One of the first applications of these structures might be to use them to support catalysts. The structures have a very high surface-to-volume ratio. A large surface area is ideal for speeding up chemical reactions, as it is easier for molecules to meet up with each other and react.

The group hopes that, by modelling such natural processes, it can not only work out more about the lifestyle of radiolaria but also use their chemical prowess to build new structures. Dr Volkmer hints that he and his colleagues intend to use more sophisticated precursor compounds, such as polymers and charged particles. These, he explains, could be used to create even more complex three-dimensional shells for other applications. Maybe it is nature, rather than necessity, that is the mother of invention.

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About sponsorship

Condor breeding

Spreading wings

Jan 23rd 2003 | SIERRA SAN PEDRO MARTIR
From The Economist print edition

Coping with troublesome young birds

Get article background

THE latest effort to save the Californian condor from extinction is under way in the remote mountain ranges of Baja California. It began last October, when three young condors were released from an acclimatisation cage perched high on the western ramparts of the Sierra San Pedro Martir. Two more will be released in the next few weeks, while the middle-aged, female “mentor bird” who accompanied them will return to the breeding site at San Diego Wild Animal Park. These mountains are within the birds' historic range but the last condors recorded there were killed in the 1930s. Their tough quill-feathers were sought after by local prospectors to make containers for gold dust.

The Californian condor is one of the world's largest flying birds, with a wingspan of around three metres (ten feet). But it has been in decline for centuries, a victim of changes to habitat, poisoned bait put out for predator control and, more recently, pesticides. (These accumulate in its tissues, or at least did so when DDT was in use.) It is also a victim of its own showiness, which has unfortunately encouraged random shootings.

That showiness may now save the condor. It has certainly brought in allies. In 1982, when only 22 birds were known to exist in the wild, America's Fish and Wildlife Service decided to capture the entire population and begin a captive-breeding programme. Despite opposition from some conservationists, the birds were captured, many by using an ancient trick known as an “eagle pit”. A deep hole is dug in a hillside and covered with brush. A hunter crouches inside, within easy reach of a sun-ripened still-born calf. When the condor lands to enjoy the windfall, the hunter lunges from the hole and grabs the bird by both legs.

The captured condors reproduced successfully, but attempts to return their offspring to the wild foundered on a lack of cultural knowledge—condor culture, that is, not human. As Mike Wallace, the leader of the California condor recovery team, of the Fish and Wildlife Service, says condors are like primates in that they have to learn how to behave from their parents. It soon became obvious that the first captive-raised condors, released in 1992, had no clue about proper condor behaviour.

According to Dr Wallace, it was “like ‘Lord of the Flies'”. The condors proved to have great curiosity, but no caution at all. He describes how, on days when the winds were right, they would all fly to a place called the Pine Mountain Club and watch people having barbecues. On other days they would circle parked pick-up trucks, then swoop down and tear off their windscreen wipers. Such adventures (which included mass vandalism of buildings and equipment at the Pine Mountain Club) came at a price—a 30-40% annual mortality rate. They also prompted vocal opposition to condor-recovery efforts in southern California.

The release on the Mexican side of the border will test a new rearing technique designed to overcome these problems. Humans wearing a condor-shaped glove puppet (developed by Mr Wallace) have fed the nestlings, and they have been kept in close proximity to a group of older condors so that they can observe and learn from their elders' behaviour. In the wild, according to Mr Wallace, condors are raised alone, in a secluded nest, with two stern and hierarchical parents. There is, as he puts it, “no big rumpus, like we had in our cages. It produces a more timid, cautious bird, one more likely to survive.” Now, birds for release are accompanied by a mentor bird.

The Baja condors may be arriving at the last really good habitat. The gold prospectors are long gone. The mountains and their flanking deserts are sparsely populated. The local livestock roams widely, and

perishes often enough to provide a carrion supply. The thermal currents that the birds require for their endless soaring come off the deserts and rise above the pine-forested mountains, providing a view of both the fog-shrouded Pacific Ocean and the salt flats of the Sea of Cortes. It sounds idyllic, if only the birds can learn to behave like grown-ups this time.

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About sponsorship

Luis Barragán

The colours of serenity

Jan 23rd 2003 | MEXICO CITY
From The Economist print edition

Armando Salas Portugal courtesy of the Barragan Foundation

Mexico's best known modernist architect lives on, 15 years after his death, in an exhibition by artists whose work he inspired

LUIS BARRAGAN'S house is an oasis. High walls keep out the urban chaos of Mexico City and protect the space within. Shafts of light pierce high windows as though they were beamed down from heaven. It feels more like a temple than a townhouse, yet it is so suffused with the spirit of the architect who built it that he seems just to have stepped out. Which, in a way, he has.

Barragán, who died in 1988, was Mexico's pre-eminent modernist architect. He built skyscrapers, stables, a convent and several private homes, and is still influential today. To celebrate the centenary of his birth, 21 artists from Mexico and around the world spent a year visiting his home, which is now a museum, and creating works of art there. The project, called “The Air is Blue”, was dreamt up by Hans-Ulrich Obrist, a contemporary-art curator working with Laboratory Mexico City, a partnership of architects and urban theorists. Mr Obrist and his partners asked the artists to respond in particular to Barragán's intangible—almost other-worldly—fusion of light, colour and form.

One of Barragán's ambitions as an architect had been to create houses that were sanctuaries. So greatly did he cherish this idea that in 1980, when he was awarded the Pritzker prize, architecture's Nobel, he described serenity as “the great and true antidote against anguish and fear”, and urged architects “to make it a permanent guest in the home, no matter how sumptuous or humble.” Mr Obrist is something of a kindred spirit. He works for the Musée d'Art Moderne de la Ville de Paris, where he organises the “Migrateurs” series of exhibitions, in which artists pick whichever part of the museum they consider most appropriate to display their work. In his search for particular spaces, Mr Obrist has also organised exhibitions on aeroplanes and in cinemas. Two years ago, he brought together a group of contemporary artists to exhibit within the eclectic Georgian setting of Sir John Soane's museum in central London.

Free space

Both that show and “The Air is Blue” grew out of conversations Mr Obrist had with local artists who expressed a passion for these evocative spaces and longed to be let loose in them. Several of the artists in the Mexican show have sought to resuscitate aspects of Barragán's life in his home. Cerith Wyn Evans, a British artist who helped Mr Obrist organise the John Soane show, was so fascinated by the 1950s turntables that Barragán kept in every room that he set about repairing them in order to play pieces from Barragán's voluminous music collection throughout the house. “Who would have thought that he'd have 16 Eartha Kitt records and 11 different recordings of Stravinsky's ‘Rite of Spring'?” says Mr Wyn Evans.

“He had enormously broad tastes.”

Rirkrit Tiravanija, a Thai artist born in Buenos Aires, repaired Barragán's silver Cadillac and is making a film with it. Pedro Reyes, the Mexican artist who introduced Mr Obrist to Barragán's house, has created a collage of images and texts drawn from Barragán's vast library. Barragán was also a surprising influence on Brazil's neo-concrete movement in the 1960s and on artists such as Hélio Oiticica, whose brightly coloured sculptures were inspired by looking at Barragán's work. He speaks in a different tone to Lygia Pape, another Brazilian artist, who saw the rays of light streaming through Barragán's studio as a metaphor for the human spirit and created a wall construction out of golden strings that seem to reverberate in the light like an ethereal prism.

The house itself and mementoes of its creator are to be found all around the works. Art books, religious tracts and pornography fill the shelves, and his cupboards reveal him to be both profoundly religious and something of a dandy. Barragán had a complicated private life, entertaining lovers of both sexes. Despite that, he remained a bachelor and created a home that suited solitary living, with each room designed for a specific mood. He called it emotional architecture.

What gives Barrágan's house its affinity with art, though, is the way it forces a viewer to notice the aesthetic qualities of a space, rather than its functions—how bright colours affect a bare room or whether a window needs to open to a view or simply provide light. He created an unfolding sense of visual drama by having small doors open on to vast spaces, a cantilevered staircase that appears to hover in mid-air and a roof terrace with pink and violet walls to frame the sky in a surrealist embrace.

Barragán never forgot the vibrant forms and colours of the Mexican countryside where he grew up. Bougainvillea blossoms were his *madeleine*, and their magenta hue became so crucial to him that he kept a piece of pink paper by his bedside as he lay dying. He once said, “Don't look at what I do, see what I see.” The artists exhibiting in Barragán's house have tried to see through his eyes and, in the process, have extended their own vision. It may be the truest way of keeping his spirit alive.

“The Air is Blue”: Casa Luis Barragán, General Franciso Ramírez 14, Colonia Ampliación Daniel Garza, Mexico City, until February 28th. By appointment, tel: +52 (55) 55 15 49 08

“Luis Barragán—The Quiet Revolution”: Palacio de Bellas Artes, Mexico City, until February 9th. Catalogue published by Skira, Milan; 319 pages; $75

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Ralph Nader

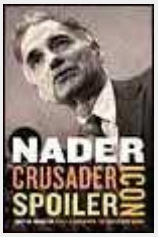
Fighting for his life

Jan 23rd 2003
From The Economist print edition

WHAT makes Ralph run? The question was asked in anguish by Ralph Nader's friends and former colleagues and in anger by Al Gore's followers during the last presidential campaign, when Mr Nader's bid to become America's first Green president split the Democratic vote. The harshest answer—ego—seems, on its own, to be an unlikely explanation. “If you want to be effective in Washington, put your own ego aside,” the veteran consumer activist once told a colleague.

Few people—elected or unelected—have been more effective in Washington than Mr Nader, or had more impact on the lives of ordinary Americans. By the age of 33, this loner, living austerely in a one-room flat and working on the sparest of budgets, had helped persuade Congress to pass laws that improved the safety of everything from chicken to natural-gas pipelines, atomic energy, X-rays, and air travel. His biggest crusade, for car safety, is said to have saved perhaps 1m lives since his book, “Unsafe at Any Speed: The Designed-in Dangers of the American Automobile”, was published in 1965. The story of how General Motors sent detectives to dig up dirt on Mr Nader, and then denied doing so, has been told before—they failed to find any dirt and their denials were exposed as lies during congressional hearings—but Justin Martin tells it again with verve, and it is a timely reminder that Mr Nader was preaching about crime in the boardroom long before the shenanigans at Enron were even a twinkle in Kenneth Lay's eye.

Nader: Crusader, Spoiler, Icon
By Justin Martin



Perseus; 336 pages; $26

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Mr Nader, who will be 69 next month, has often been likened to an Old Testament prophet, but, as one ally and friend said, “Prophets don't make good presidents...[to] call people to account for not living up to moral codes, that's the role Ralph performs best.” The author argues that Mr Nader is not well suited to public life, being both prickly and notoriously private. Why then, did he run for president? The reason, Mr Martin suggests, was that he was no longer newsworthy and, above all, that he had been shut out by Bill Clinton and Mr Gore. After 12 years of Ronald Reagan and George Bush senior, Mr Nader's natural ideological opponents, it seemed axiomatic that the activist, and his causes, finally had friends in high places. But they would not return his calls—apparently for fear of offending corporate America.

This admiring portrait can occasionally slide into a flat recitation of Mr Nader's accomplishments, but it vividly reveals the difference that one committed idealist can make. Mr Nader is described as an eccentric genius, who was driven by a finely calibrated sense of outrage and who chose to do things his own way. Or, as one of his closest allies over the years, Joan Claybrook, once put it, “He is one of the most stubborn people in the United States.” Such traits are not necessarily endearing, but they go a long way to explaining why Ralph ran—and who he is.

Nader: Crusader, Spoiler, Icon.
By Justin Martin.
Perseus; 336 pages; $26

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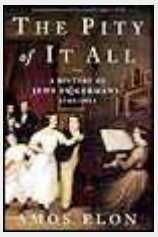
Jewish history

Give sorrow words

Jan 23rd 2003
From The Economist print edition

THIS book begins in 1743, when the 14-year-old Moses Mendelssohn arrived in Berlin to seek an education. He would become celebrated as the German Socrates and the Jewish Luther. It ends nearly two centuries later when another luminary, Hannah Arendt, left Berlin after the Nazis came to power. These two vignettes frame Amos Elon's elegiac book. They also suggest the aspects of modern German-Jewish history that really engage him. Mr Elon wants to trace "the fates and ideas of a number of interesting, mostly secular, and often very appealing people". They were, he adds, not "representative" but "emblematic", a distinction that some may find elusive.

The Pity of It All: A History of Jews in Germany, 1743-1933
By Amos Elon



Metropolitan Books; 446 pages; $30. Penguin/Allen Lane; £25

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Having begun with Mendelssohn in Enlightened Germany, Mr Elon moves on via the *salonnières*, Henriette Herz and Rahel Levin, to the politically engaged writers of Young Germany, Heinrich Heine and Ludwig Börne. An exceptionally thoughtful chapter then looks at Jews for whom the 1848 revolution provided a political stage. The collective biography thickens as Mr Elon turns to the extraordinary talent that flowered in newly unified Germany in the fields of literature, art, music, journalism, philosophy and science. This is the story of Weimar culture in waiting. The author writes the poignant end of that story in his final chapter, but not before a more-in-sorrow-than-anger reminder that Jewish intellectuals fully shared the German war fever of 1914.

Mr Elon makes familiar material absorbing with his deftly interwoven life histories (helped by the fact that so many of his principal characters were in fact related to each other) and his generous use of direct quotation from letters and diaries. Although sometimes shaky on the larger political history, he gives a good sense of the institutional settings that made a difference. The reason why so many educated Jews turned to journalism, criticism and bookselling, for example, was because they were barred from holding civil service or university posts.

But this collective portrait, undeniably attractive, remains very partial, devoted to the minority of the minority that stood for cultural, political and entrepreneurial modernity. One of the ideas that recur in the book is education as a form of secular belief, but there is little on religion itself. Mr Elon quotes Heine's sardonic description of Reform Judaism as mock turtle soup ("turtle soup without the turtle"), but he wastes little time on that phenomenon and even less on orthodoxy. A note refers to Peter Gay's provocative plea for a history of the "stupid Jew", of the ordinary businessmen, the shopkeepers and professionals whose lives belied the stereotypes of cleverness. Mr Elon is not particularly interested in this, although where he lowers his gaze to introduce a few statistics or talk about everyday matters, such as changing one's name or putting up a Christmas tree, it gives his book a valuable extra dimension.

Despite the rarefied perspective, Mr Elon's big picture is persuasive. He neatly captures the idea that Jews had to earn emancipation with his comment that they were "on probation"; and throughout the book he adroitly uses conversion (mainly to Protestantism) as an index of the continuing constraints that Jews felt in post-emancipation German society. At the same time, perhaps with right-wing Zionist critics in mind, he offers praise for a multicultural version of assimilation and warns readers not to write off the critical blue-print for self-improvement simply as Jewish self-hatred.

"The Pity of It All" succeeds, finally, at one of the hardest tasks of all. The dust jacket calls this a book that tells the story from the beginning, not the end. It's a fair claim, for one of the greatest achievements of Mr Elon's humane and lucid account is his ability to balance the open-endedness of history as it was lived by his characters and the various foreshadowings of catastrophe that are now evident to us.

The Pity of It All: A History of Jews in Germany, 1743-1933.
By Amos Elon.
Metropolitan Books; 446 pages; $30. Penguin/Allen Lane; £25

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Psychology

The Goon show

Jan 23rd 2003
From The Economist print edition

SCIENCE usually works best when it is dealing with the unknown or the unexpected. Sometimes, though, a scientist finds himself in the odd position of having to prove the obvious. Harry Harlow was just such a scientist: he had to prove the existence of love.

When Harlow was training as a psychologist in the 1920s his subject appeared to have lost its bearings. A fierce desire to purge the field of subjectivity and anecdote, replacing them with controlled and repeatable experiments, had produced a monster that arrogantly denied meaning to what could not be quantified, rather than recognising the limits of its techniques. This simplified behaviourist approach found that animals such as rats and pigeons were good analogues ("models", in the jargon) of humans—with the added advantage that they did not have human rights to constrain the experimenters. Oddly enough, many of these same psychologists also persisted with the quasi-religious belief that there exists an unbridgeable intellectual and emotional distinction between man and other animals.

Love at Goon Park: Harry Harlow and the Science of Affection
By Deborah Blum

Perseus; 352 pages; $26. John Wiley; £17.99

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Harlow discovered the existence of a bridge between human and non-human and devised the rigorous scientific experiments that would prove its existence to the satisfaction of the behaviourists. But the very process of doing so blurred the ethical divide between humans and other animals, and ultimately helped create the animal-rights movement that came to excoriate his work.

The bridge was built out of monkeys. Deborah Blum, a Pulitzer prize-winning science writer, describes Harlow's discovery, made in the Henry Vilas Park Zoo, in Madison, Wisconsin, that apes and monkeys were actually far cleverer than rats. She chronicles his struggles to persuade his fellow-psychologists and the University of Wisconsin's administrators, who were funding his work, to take him seriously. As far as the university authorities were concerned, rats and monkeys were both on the wrong side of the tracks, psychologically speaking. Being equally non-human, many people believed either would do as a model. And rats were cheaper, by far.

The work culminated in the 1950s and 1960s in a series of experiments on mother-child bonding in rhesus monkeys. With hindsight, many of Harlow's tests seem quite hideous. In order to demonstrate that it was comfort rather than food alone that baby monkeys sought from their mothers, he created a pair of monstrous models: cloth mother and wire mother. Cloth mother was soft and cosy. Wire mother was hard and uncomfortable, but delivered milk. No prizes for guessing which one the babies preferred to cling to. Some mothers were even worse. In order to investigate maternal rejection, brass-spike mother, air-blast mother and others like them were brought into play. Harlow had no time for the euphemisms which, even today, are used to soften the descriptions of experimental procedures in scientific papers. The apparatus he devised to impregnate females whose courtship skills had been destroyed by their sterile upbringing was known as the rape rack. The inverted pyramid used to impose isolation, in order to investigate the origins of depression, was the pit of despair.

The results were exactly what you might have expected. Children need mother love. Upbringing matters. Females who are neglected as children go on to neglect their own children. But Harlow's experiments were needed to convince the experts of this self-evident truth. And those experts held sway over the child-rearing practices of the day. Monkeys had to suffer so that children might not. The University of Wisconsin's psychology department was nicknamed "Goon Park" because its address, 600 N. Park, could read that way on carelessly addressed letters. As a comment on crude behaviourism, though, the name

could not be bettered.

Love at Goon Park: Harry Harlow and the Science of Affection.
By Deborah Blum.
Perseus; 352 pages; $26.
John Wiley; £17.99

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Scent

Who knows why the nose knows

Jan 23rd 2003
From The Economist print edition

LEGEND has it that when the royal family tried to flee France disguised as commoners during the revolution, they were betrayed by Marie Antoinette's perfume. As she emerged from their carriage at Varennes, her heavenly Houbigant scent revealed her to be no ordinary *citoyenne*.

The French are renowned for their sensitivity to smell—Parisian cabbies are said to be able to name perfumes that linger in their cabs long after the wearer is gone. Theirs is assumed to be a culturally conditioned talent. Sensitivity to smell is believed to be the result of nurture not nature and is bound up with Proustian memories, sexual instincts and other enigmatic impulses. Alone of all the senses, smell has remained a mystery; no one yet has fully understood how the nose knows.

Luca Turin, one man with a powerful nose and a bizarre obsession with perfume devoted himself to solving the riddle: he claimed that just as humans can see the colour blue and hear an A chord, we can all smell the scent of a rose in the same way. While different cultures may have particular olfactory tastes, smell, like the other senses, can be studied objectively. The reason for this, he believes, is that the olfactory receptors in the nose react to the vibrations of the atoms connected by the electron bonds in a scent molecule. Essentially, our noses act as biological spectroscopes—or electron-measuring devices—that can perceive an unlimited number of electron vibrations and hence smells.

The Emperor of Scent: A Story of Perfume, Obsession, and the Last Mystery of the Senses
By Chandler Burr

Random House; 368 pages; $24.95

Buy it at
Amazon.com

In a nutshell, this is the vibration theory of smell proposed in 1996 by Mr Turin, a former lecturer in the physiology department of University College London and now would-be odorant industrialist. But the theory contradicted everything that the scientific community and the $20-billion-a-year perfume industry believes about smell. Most experts subscribe to the shape theory: we smell a certain scent because our smell receptors recognise its molecular shape. Mr Turin said this was impossible because there are molecules with different shapes that both smell of rotten eggs (sulphur and borane) and there are molecules with the same shape that smell different (ferrocene and nickelocene).

He was by turns shunned, vilified and laughed at by everyone who was anyone in the world of smell. “The Emperor of Scent” tells this story and chronicles Mr Turin's futile struggles against vested interests to gain recognition of his theory.

Sadly, Mr Turin's fascinating story is poorly told. Chandler Burr's writing tries too hard to be hip, while at the same time devoting interminable passages to the ping-pong volleys of scientific argument. The reader emerges exhausted by the battle over the theory of smell but also wondering what has become of it since 1996 and how Mr Turin's new odorant design company, Flexitral, is faring. This is a pity, because along the way we have been fed some tantalising scraps about the weird world of perfumery. The reader yearns to learn more about Ernst Beaux, perfumer to the last tsar, who fled to Paris and, in 1921, created Chanel No. 5. The world's first abstract perfume, it was based not on a recognisable floral fragrance but on a composition of disparate olfactory notes—perfume as abstract art.

In his spare time, Mr Turin channelled his odoriferous obsession into writing a guide to perfumes that was filled with poetic reviews of legendary scents. One review proclaims that, “like Chamade, Rive Gauche enjoys a peculiar relationship with intensity: the more time passes, the stronger its grace becomes, as if fading allowed its inner light to radiate more easily.” Mr Turin's gift for describing elusive olfactory nuances should inspire readers to follow their noses to the nearest fragrance counter and sniff. He ought

to consider writing his own story.

The Emperor of Scent: A Story of Perfume, Obsession, and the Last Mystery of the Senses.
By Chandler Burr.
Random House; 368 pages; $24.95

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New fiction

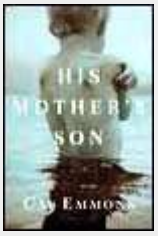
The killing fields

Jan 23rd 2003
From The Economist print edition

JANA THOMAS is the kindest doctor in the Bellingham, Washington, emergency room. Outside it, she is unbearable. Tense and jumpy, Jana is such a stern mother she freaks out other mums. At the age of six, her son, Evan, “her slightly odd child”, begins to have sudden outbursts of rage. He bites other children at nursery school. He punishes his stuffed animals, hurls them against the wall, slices them open raggedly with his blunt toy scissors. “I'm operating on them to remove their bad,” he says, and his mother begins to wonder if this is a turning point, or what Jana calls “*the* turning point”.

What no one knows, certainly not Jana's kindly carpenter husband Cooper, is that Jana's real name is Cadence Miller and that when she was at university her younger brother, Varney, shot dead their parents, a teacher and a rival student. Jana had been the one who protected Varney from their violent father, but she could not save her parents from Varney. Or Varney from himself. Looking back, she constantly asks two questions: was there a moment when Varney turned bad and could the same happen to Evan?

His Mother's Son
By Cai Emmons



Harcourt; 366 pages; $25

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Cooper and his mother see the boy as rambunctiously normal. It is Jana, they believe, who is violent. But as Jana turns these two central questions over and over, her son's aggression begins to drive her to the edge. And the isolation imposed by her secretiveness comes to threaten not just her marriage, but her very self.

When Jana learns that Varney, whom she has not seen since his trial, is dying of AIDS in a California prison hospice, she sets off alone on a pilgrimage that begins in loneliness, but which, in turn, is the only thing that can lead her back to her husband and her son.

Cai Emmons, a playwright and film maker who now teaches at the University of Oregon, has an eye for the grating intimacy of small-town life and a fine ear for suggestive metaphors (as Jana retreats during an argument with Cooper, “His voice pummels at her back”; a dying patient's “breath crackles with the...unpredictability of a package being unwrapped.”) As a debut, “His Mother's Son” is both unusual and memorable.

His Mother's Son.
By Cai Emmons.
Harcourt; 366 pages; $25

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Correction: The destruction of Warsaw

Jan 23rd 2003
From The Economist print edition

Our historical memory failed in the review of Roman Polanski's film “The Pianist” (January 9th). Warsaw was destroyed in the second world war not by allied bombs, as we wrote, but by German demolition squads. Sorry.

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Françoise Giroud

Jan 23rd 2003
From The Economist print edition

Françoise Giroud, a French writer and politician, died on January 19th, aged 86

EPA

THE brave ambition of Françoise Giroud was, as she put it, “to move France out of its rut”. Americans, she thought, had the right idea. They never seemed to get into a rut. On her first visit to New York soon after the end of the second world war she had been struck by “the degree of optimism, the exhilaration” she had found there. That view stayed with her: “There is a strength in the United States that we in Europe constantly tend to underestimate.” Miss Giroud's views were not always well received by the French, who do not consider themselves in any way inferior to the Americans, or indeed to anyone else. They denied they were in a rut, but even if they were it was one of elegant and enviable proportions.

Miss Giroud's weapon to give more pace to French life was language. During her long life she worked in films, was a journalist and a government minister. The thread that linked these jobs was a way with words. For many French people she became an addiction, whether they agreed with her or not. She edited two magazines entirely new to France, *Elle* and *L'Express*. *Elle* aimed to be provocative. An article Miss Giroud wrote in 1951 was entitled “Is the Frenchwoman clean?” A woman would buy a new dress because she wanted to look good, she wrote. “But under the dress, what are you wearing? A garter-belt that has not been washed in two years. That is the national average.” The indignation Miss Giroud aroused by discussing personal hygiene quickly became of lesser importance amid a national debate that ensued over whether La France herself was clean. In the years after the second world war many French people were feeling that the stain of the German occupation, and its accompanying collaboration by the Vichy government, had not been cleansed. Others argued passionately that France had to give up Vietnam and Algeria and abandon the dirty ways of colonialism. *Elle* offered Frenchwomen a view of the world beyond the home.

L'Express, France's first weekly news- magazine, was a challenge to xenophobic French. The French, Miss Giroud said, were among those westerners “most ill-informed about themselves”. News magazines keep Americans informed. Try ours. The French did and they liked it. Perhaps they were moving out of their rut.

Through the fog

In 1974 Jacques Chirac, the then prime minister, created for Françoise Giroud the new job of minister of women's affairs. She was later made culture minister. But although she came to be described as a feminist, she was never a campaigning American-style sister. Nor was she in the philosophical mould of Simone de Beauvoir. More practically, she sought to help French women find their way through what she called “the fog” of a male-run world. Women bought most of the products consumed in the home, but were ignorant of how they were made or the economics of their marketing. In politics, especially, the fog was thick, and remains so. In the lower house of the present French parliament fewer than 11% of its members are women, one of the lowest in Europe. Three women are in the cabinet but, said Miss Giroud, “we have had women ministers for decades”. Nor did she approve of the jobs they were often given. A ministry for women was “a shallow answer to a non-existent problem”.

As Miss Giroud became well known she was pressed for details of her own life, and obligingly offered some colourful stories, such as when she was an aide to Jean Renoir in 1937 while he was making “La Grande Illusion”, regarded as one of the greatest of anti-war films. “You have gifts,” he told her.

In her book “I Give You My Word” she tells of being arrested towards the end of the war by the Gestapo on suspicion of helping the resistance. She was released and her confiscated watch was returned to her by a helpful German. “A complete German absurdity,” she writes. Miss Giroud shared the shame of those French who believed the government should have fought on in 1940, but she had been sure that the Germans would be defeated. “I never for a minute doubted the moral superiority of England, and for me that explained how it was able to hold out.”

She had little education to speak of. She left school at 14 and worked first in a shop, then as a typist, after her father, a journalist, died and her mother had no money. Or, it could be said, she gradually acquired a broad education through reading. Two of her heroines were Marie Curie, a pioneer in the study of radioactivity, and Alma Mahler, who gained rather more notorious fame as a result of her love affairs. Miss Giroud was to write biographies of both women. She preferred to say little about her own love life. She was married briefly and had two children, a son who died in a skiing accident, and a daughter who survives her. She said, “The men who helped me, and they are legion, were my friends, not my lovers.”

She was writing a regular column, for a news magazine, up to a few days before her death. A recent article was about the conflict in Israel. She chides both sides, but characteristically avoids a rush to judgment. She once said, “Off the rack solutions, like bargain basement dresses, never fit anyone.”

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Overview

Jan 23rd 2003
From The Economist print edition

America's economy is sending mixed signals. Industrial production fell by 0.2% in December. Although consumer-price inflation quickened, it was more subdued than expected, thanks to falling car prices. Construction of new homes hit a 16-year high in December. The robust house-building figures lend hope that America's economy grew rather than contracted in the fourth quarter.

Consumer-price inflation in **the euro area** was revised upwards to 2.3% for the year to December. Economic growth in the Netherlands was 0.3% in the year to the third quarter. Austria's economy grew by 1.2% during the same period. As Australia's economy continues its strong growth, producer prices rose by 1.2% in the fourth quarter.

Japan's industrial output slid for the third month running in November, falling by 1.6%.

In **Britain**, inflation excluding mortgage-interest payments (the measure the government uses for its inflation target of 2.5%), fell from 2.8% in the year to November to 2.7% in December. Fierce retail competition and falling food prices more than offset rising prices in household services and housing costs. Manufacturers remained glum, according to a quarterly survey by the Confederation of British Industry. The CBI said that 74% of firms were operating below capacity, the largest figure for 20 years.

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Output, demand and jobs

Jan 23rd 2003
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr*	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 3.5	+ 3.7 Q3	+ 3.7	+ 3.2	+ 1.6 Q3	+ 5.4 Q3	6.2 Dec	6.7
Austria	+ 0.3	+ 1.2 Q3	+ 0.7	+ 1.3	− 2.9 Oct	+ 3.8 Oct	4.1 Nov	3.8
Belgium	+ 1.2	+ 0.8 Q3	+ 0.6	+ 1.4	+ 3.1 Nov	nil Oct	11.7 Dec†	10.8
Britain	+ 3.4	+ 1.8 Q3	+ 1.6	+ 2.4	− 1.1 Nov	+ 6.4 Dec	5.2 Nov††	5.1
Canada	+ 3.1	+ 4.0 Q3	+ 3.3	+ 3.1	+ 5.2 Oct	+ 6.0 Oct	7.5 Dec	8.0
Denmark	− 3.8	+ 0.9 Q3	+ 1.5	+ 1.8	− 0.8 Nov	+ 7.5 Oct	5.4 Nov	5.0
France	+ 0.9	+ 0.8 Q3	+ 1.0	+ 1.6	+ 1.5 Oct	+ 2.5 Nov	9.0 Nov	8.8
Germany	+ 1.1	+ 0.4 Q3	+ 0.2	+ 0.8	+ 2.5 Nov	− 6.0 Nov	10.1 Dec§	9.5
Italy	+ 1.1	+ 0.5 Q3	+ 0.4	+ 1.3	+ 5.6 Nov	− 0.7 Oct	8.9 Oct	9.3
Japan	+ 3.2	+ 1.3 Q3	− 0.3	+ 0.4	+ 5.1 Nov	− 1.8 Nov	5.3 Nov	5.4
Netherlands	+ 1.0	+ 0.3 Q3	+ 0.2	+ 1.0	+ 0.1 Nov	− 1.1 Nov	2.5 Dec**	1.8
Spain	+ 3.2	+ 1.8 Q3	+ 2.0	+ 2.3	+ 0.8 Nov	na	11.8 Nov	10.7
Sweden	+ 1.6	+ 2.0 Q3	+ 1.8	+ 2.1	− 0.5 Nov	+ 4.6 Nov	3.9 Nov†	3.7
Switzerland	+ 1.3	+ 0.6 Q3	− 0.1	+ 1.0	− 3.5 Q3	− 4.1 Nov	3.6 Dec†	2.4
United States	+ 4.0	+ 3.2 Q3	+ 2.4	+ 2.5	+ 2.1 Dec	+ 3.3 Nov	6.0 Dec	5.8
Euro area	+ 1.3	+ 0.8 Q3	+ 0.7	+ 1.3	+ 3.0 Nov	+ 1.6 Oct	8.4 Nov	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 1.9	+ 2.3 Q3	na	na	+ 5.4 Nov	+ 3.8 Oct	8.1 Dec†	8.1
Greece	na	+ 3.6 Q3	na	na	+ 1.1 Nov	na	na	na
Iceland	na	+ 3.1 2001	na	na	+ 3.3 2001	na	2.8 Nov†	1.5
Ireland	na	+ 6.5 Q2	na	na	+18.6 Nov	+ 1.1 Oct	4.4 Dec	4.1
Luxembourg	na	+ 3.5 2001	na	na	− 0.7 Oct	− 5.6 Aug	3.3 Nov†	2.7
New Zealand	+ 5.0	+ 5.0 Q3	na	na	+ 5.1 Q3	+ 8.1 Q3	5.4 Q3	5.2
Norway	− 0.9	+ 1.0 Q3	na	na	− 5.1 Nov	+ 2.8 Oct	3.8 Q3	3.6
Portugal	+ 2.8	+ 0.9 Q2	na	na	− 3.7 Nov	+ 0.6 Nov	5.1 Q3†	4.0

*% change at an annual rate. †Not seasonally adjusted. ††Sep-Nov; claimant count rate 3.1% in Dec. §EU harmonised rate 8.5% in Dec.
**Oct-Dec.

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Prices and wages

Jan 23rd 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 3.0	Q4	+ 3.1	+ 3.0	+ 2.7	+ 1.6	Q4	– 0.7	+ 3.6	Q3	+ 4.0
Austria	+ 1.8	Dec	+ 1.9	+ 1.8	+ 1.6	+ 0.8	Dec	– 1.1	+ 2.2	Nov	+ 2.7
Belgium	+ 1.4	Dec	+ 2.2	+ 1.7	+ 1.3	+ 1.4	Dec	– 2.6	+ 2.2	Q4	+ 3.1
Britain	+ 2.9	Dec	+ 0.7	+ 1.9	+ 2.5	+ 1.2	Dec	– 1.1	+ 3.8	Nov	+ 4.1
Canada	+ 3.9	Dec	+ 0.7	+ 2.2	+ 2.5	+ 2.2	Nov	– 2.1	+ 2.4	Oct	+ 2.5
Denmark	+ 2.5	Dec	+ 2.2	+ 2.4	+ 2.0	+ 1.3	Dec	+ 0.4	+ 3.9	Q3	+ 4.3
France	+ 2.3	Dec	+ 1.4	+ 1.8	+ 1.5	+ 0.9	Nov	– 2.2	+ 3.4	Q3	+ 4.2
Germany	+ 1.1	Dec	+ 1.7	+ 1.3	+ 1.0	+ 1.1	Dec	– 1.5	+ 2.5	Oct	+ 2.3
Italy	+ 2.8	Dec	+ 2.4	+ 2.5	+ 2.1	+ 1.2	Nov	– 1.3	+ 2.1	Nov	+ 2.8
Japan	– 0.4	Nov	– 1.0	– 0.9	– 0.7	+ 0.3	Nov	– 0.8	+ 0.6	Nov	+ 0.6
Netherlands	+ 3.2	Dec	+ 4.4	+ 3.8	+ 2.5	+ 2.1	Nov	– 2.5	+ 3.4	Nov	+ 4.9
Spain	+ 4.0	Dec	+ 2.7	+ 3.5	+ 2.8	+ 1.7	Nov	– 0.8	+ 3.8	Q3	+ 3.6
Sweden	+ 2.3	Dec	+ 2.9	+ 2.4	+ 2.0	– 0.8	Nov	– 0.9	+ 3.1	Oct	+ 2.6
Switzerland	+ 0.9	Dec	+ 0.3	+ 0.7	+ 0.7	– 0.3	Dec	– 1.9	+ 2.5	2001	+ 1.3
United States	+ 2.4	Dec	+ 1.6	+ 1.6	+ 2.0	+ 1.2	Dec	– 1.6	+ 3.0	Dec	+ 3.7
Euro area	+ 2.3	Dec	+ 2.0	+ 2.2	+ 1.7	+ 1.1	Nov	– 1.3	+ 3.3	Q3	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.7	Dec	+ 1.8	na	na	+ 1.4	Dec	– 2.7	+ 3.5	Q3	+ 4.7
Greece	+ 3.4	Dec	+ 3.0	na	na	+ 2.1	Nov	– 0.5	na		na
Iceland	+ 1.4	Jan	+ 9.4	na	na	+ 2.7	Jan	+11.4	+ 5.4	Dec	+ 9.6
Ireland	+ 5.3	Dec	+ 5.0	na	na	– 1.2	Nov	nil	+ 6.2	Q3	+ 8.1
Luxembourg	+ 2.2	Dec	+ 1.7	na	na	– 0.2	Nov	– 1.0	+ 0.3	Oct*	+ 2.2
New Zealand	+ 2.7	Q4	+ 1.8	na	na	– 1.7	Q3	+ 6.2	+ 2.3	Q3	+ 2.0
Norway	+ 2.8	Dec	+ 2.1	na	na	+10.1	Dec	–14.1	+ 5.0	Q3	+ 4.8
Portugal	+ 4.0	Dec	+ 3.7	na	na	+ 1.7	Nov*	+ 0.6	– 0.7	Nov*	+ 4.2

*Revised series.

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Portfolio poll

Jan 23rd 2003
From The Economist print edition

Portfolio poll

4th quarter 2002

▼▲ A change of 5% points or more on last quarter
▼▲ A change of less than 5% points on last quarter

	Holdings by instrument, %			Equity holdings by area, %						
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia
Robeco Group	53	47	0	57	2	12	13	5	7	4
Julius Baer PB	40	47	13†	45	8	7	16	8	8	8
Commerz Int. CM	48 ▼	32 ▼	20 ▲	57 ▲	2 ▲	10 ▼	18 ▲	3 ▼	8	1 ▼
Credit Suisse PB	28	38	34†	59	0	9	14	4	5	9
Lehman Brothers	70	30	0	38	0	13	26	5	14	4
Standard Life	55	45	0	57	0	12	14	5	9	3
Daiwa IR	60	34	6	53	2	11	18	5	8	3
Average	51 ▼	39 ▼	10 ▲	52	2	10 ▼	17	5	8	5
Neutral*				56	2	11	13	5	10	3

	Bond holdings by currency, %				
	Dollar	Yen	Sterling	Euro-zone	Others
Robeco Group	31	19	5	36	9
Julius Baer PB	88	0	0	7	5
Commerz Int. CM	50 ▼	15 ▼	10 ▼	15 ▲	10 ▲
Credit Suisse PB	84	0	0	16	0
Lehman Brothers	47	18	4	28	3
Standard Life	26	29	6	39	0
Daiwa IR	32	14	6	43	5
Average	51 ▼	14	4 ▼	26 ▲	5 ▲
Neutral*	24	29	5	37	5

*Morgan Stanley Capital International (developed) world equity index; Salomon Brothers world government-bond index
†Of which 7% invested in alternative investments

All fund managers in our poll were extremely cautious during the fourth quarter of last year and hardly changed the composition of their model portfolio. The main reasons are uncertainty about the war in the Gulf and doubts about a recovery of the global economy. Indeed, money managers at Commerzbank were the only ones to move at all, shifting funds out of equities and into cash.

They reduced their holding of British equities, which are currently at 30-year valuation lows, in favour of American, European and Latin American shares. They were sceptical about the weakening dollar, cutting down their holding of bonds denominated in dollars, and increasing by 5% or more their share of bonds denominated in euros.

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Money and interest rates

Jan 23rd 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jan 22nd 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 8.1	+ 9.7	Nov	4.79	4.25	4.54	5.21	5.88	6.14
Britain	+ 5.1	+ 6.9	Dec	3.91	3.94	3.72	4.33	4.82	5.81
Canada	+ 9.8	+ 6.1	Nov	2.74	1.93	3.30	4.91	5.41	6.83
Denmark	+ 6.6	+ 6.2	Nov	3.11	3.55	2.93	4.31	4.97	6.81
Japan	+25.2	+ 2.2	Dec	0.03	0.03	0.05	0.81	1.43	0.94
Sweden	+ 1.8	+ 4.8	Sep	3.66	3.77	3.73	4.59	5.18	4.21
Switzerland	+12.3	+ 5.1	Nov	0.60	1.72	0.25	2.34	3.39	3.16
United States	+ 3.4	+ 6.3	Dec	1.25	1.70	1.62	3.92	5.02	6.30
Euro area†	+ 9.1	+ 7.1	Nov	2.83	3.36	2.59	4.05	4.75	4.57

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.85%, Japan No.245 0.805%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.75%, BOJ overnight call 0.002%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jan 23rd 2003
From The Economist print edition

1995=100

	Jan 14th	Jan 21st*	% change on one month	% change on one year
Dollar index				
All items	75.9	76.9	+ 1.5	+14.4
Food	78.1	79.2	+ 0.0	+15.4
Industrials				
All	72.9	73.9	+ 3.7	+13.1
Nfa†	76.3	75.7	+ 2.8	+18.9
Metals	70.0	72.4	+ 4.5	+ 8.3
Sterling index				
All items	74.3	75.4	+ 0.7	+ 1.5
Euro index				
All items	94.2	94.8	– 2.0	– 5.4
Yen index				
All items	95.3	97.1	+ 0.2	+ 1.1
Gold				
$ per oz	352.00	356.80	+ 3.3	+26.4
West Texas Intermediate				
$ per barrel	32.40	34.06	+ 6.7	+75.3

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jan 23rd 2003
From The Economist print edition

Market indices

	Jan 22nd	2002-03 high	2002-03 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,999.1	3,440.0	2,855.5	– 1.7	–12.8	–10.7	+ 2.1
Austria (ATX)	1,154.5	1,357.2	1,003.7	– 1.6	–33.5	+ 1.2	+21.7
Belgium (Bel 20)	1,885.7	2,899.8	1,773.7	– 6.2	–48.8	–32.2	–18.5
Britain (FTSE 100)	3,678.0	5,323.8	3,671.1	– 5.4	–46.9	–29.5	–21.8
Canada (Toronto Composite)	6,721.3	7,958.1	5,695.3	– 1.2	–41.0	–12.6	– 9.0
Denmark (KBX)	166.8	233.4	156.4	– 1.7	–44.7	–25.8	–10.8
France (SBF 250)	1,974.3	3,081.9	1,794.5	– 5.9	–55.0	–33.8	–20.4
(CAC 40)	2,931.4	4,688.0	2,656.5	– 6.5	–57.7	–36.6	–23.8
Germany (Xetra DAX)	2,803.3	5,462.6	2,597.9	– 8.1	–65.2	–45.7	–34.7
Italy (BCI)	1,062.3	1,513.0	974.4	– 6.5	–51.3	–25.9	–10.9
Japan (Nikkei 225)	8,611.0	11,979.9	8,303.4	nil	–77.9	–18.3	– 9.6
(Topix)	854.1	1,139.4	760.1	– 0.2	–70.4	–17.3	– 8.4
Netherlands (AEX)	300.8	531.2	291.4	– 9.1	–57.1	–40.6	–28.6
Spain (Madrid SE)	651.5	848.1	568.5	– 4.2	–43.2	–21.0	– 5.0
Sweden (Affarsvarlden Gen)	146.9	236.8	122.7	– 3.5	–63.3	–36.5	–22.9
Switzerland (Swiss Market)	4,520.2	6,694.1	4,435.0	– 7.0	–46.3	–29.6	–14.4
United States (DJIA)	8,318.7	10,635.3	7,286.8	– 4.6	–29.0	–17.0	–17.0
(S&P 500)	878.4	1,172.5	776.8	– 4.3	–42.5	–23.5	–23.5
(NASDAQ Comp)	1,359.5	2,059.4	1,114.1	– 5.5	–73.1	–30.3	–30.3
Europe (FTSE Eurotop 300)*	812.1	1,279.7	797.2	– 6.6	–52.4	–35.6	–22.6
Euro area (FTSE Ebloc 100)*	689.1	1,125.1	639.4	– 7.3	–55.6	–38.0	–25.5
World (MSCI)†	787.0	1,024.4	703.7	– 4.2	–45.7	na	–21.6
World bond market (Salomon)‡	532.5	527.1	430.3	+ 0.9	+ 0.3	na	+21.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jan 23rd 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† 1990=100 Jan 22nd	year ago	Currency units per $ Jan 22nd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	− 3.8	Nov	− 14.3	Q3	− 3.9	− 4.1	75.2	74.9	1.71	1.92	2.76	1.83	1.44	0.1
Austria	nil	Oct	− 0.6	Nov	− 0.4	− 0.7	101.1§	100.0	0.93	1.13	1.51	–	0.79	-1.6
Belgium	+ 18.0	Nov	+ 13.3	Sep	+ 5.0	+ 5.0	100.4§	98.8	0.93	1.13	1.51	–	0.79	nil
Britain	− 51.1	Nov	− 20.5	Q3	− 1.7	− 1.8	103.2	106.4	0.62	0.70	–	0.66	0.52	-1.4
Canada	+ 28.9	Nov	+ 12.4	Q3	+ 1.9	+ 1.9	76.7	75.3	1.53	1.61	2.47	1.64	1.29	0.6
Denmark	+ 7.4	Nov	+ 4.0	Nov	+ 2.3	+ 2.0	104.5	102.5	6.95	8.41	11.2	7.44	5.86	2.2
France	+ 8.1	Nov	+ 25.2	Oct	+ 1.6	+ 1.6	103.4§	101.4	0.93	1.13	1.51	–	0.79	-2.7
Germany	+118.4	Nov	+ 45.3	Nov	+ 1.8	+ 1.7	100.4§	98.1	0.93	1.13	1.51	–	0.79	-3.7
Italy	+ 11.1	Oct	− 2.8	Oct	− 0.1	− 0.1	73.7§	72.4	0.93	1.13	1.51	–	0.79	-2.3
Japan	+ 92.6	Nov	+114.8	Nov	+ 2.8	+ 2.8	132.0	126.3	118	134	191	127	–	-7.9
Netherlands	+ 28.0	Nov	+ 9.0	Q3	+ 3.6	+ 3.4	99.5§	97.7	0.93	1.13	1.51	–	0.79	-0.8
Spain	− 38.7	Nov	− 14.3	Oct	− 2.1	− 1.8	75.3§	74.1	0.93	1.13	1.51	–	0.79	nil
Sweden	+ 14.5	Nov	+ 10.8	Nov	+ 3.4	+ 3.2	78.0	75.5	8.64	10.5	13.9	9.25	7.30	1.7
Switzerland	+ 4.5	Nov	+ 29.8	Q3	+10.0	+10.3	116.6	112.5	1.37	1.67	2.20	1.46	1.15	na
United States	−467.0	Nov	−462.2	Q3	− 4.7	− 5.0	108.8	123.8	–	–	1.61	1.07	0.84	-3.1
Euro area	+ 98.3	Nov	+ 37.4	Oct	+ 0.6	+ 0.7	85.8	79.1	0.93	1.13	1.51	–	0.79	-2.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.5	Nov	+ 10.0	Nov	na	na	79.3§	78.3	0.93	1.13	1.50	–	0.79	3.2
Greece	− 21.1	Nov	− 8.4	Nov	na	na	58.2§	57.4	0.93	1.13	1.50	–	0.79	-1.1
Iceland	+ 0.2	Nov	nil	Q3	na	na	91.9**	84.9	79.2	102.3	128	84.8	66.9	0.3
Ireland	+ 35.2	Oct	+ 0.1	Q3	na	na	89.8§	87.1	0.93	1.13	1.50	–	0.79	-0.5
Luxembourg	− 2.7	Oct	+ 2.1	Q3	na	na	100.4§	98.8	0.93	1.13	1.50	–	0.79	1.8
New Zealand	− 0.5	Nov	− 1.7	Q3	na	na	95.5	84.1	1.84	2.33	2.97	1.97	1.55	1.6
Norway	+ 25.7	Dec	+ 25.0	Oct	na	na	107.1	97.1	6.91	8.95	11.1	7.40	5.83	12.4
Portugal	− 12.7	Oct	− 9.9	Oct	na	na	91.1**	90.2	0.93	1.13	1.50	–	0.79	-3.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, November average. ‡OECD forecast. **IMF, September average.

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Household saving

Jan 23rd 2003
From The Economist print edition

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Overview

Jan 23rd 2003
From The Economist print edition

Mexico's peso fell to 10.83 to the dollar, the lowest closing rate ever. **Peru's** annualised rate of GDP growth rose to 5.9% in November from 4.5% in October.

Economic growth in **Egypt** slowed to 3.1% in the year to June 2002 from 3.3% in the previous year.

In **Venezuela**, where the stockmarket has been closed since December, the central bank said it would halt foreign-exchange trading for five days to stop capital outflows.

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The Economist poll of forecasters

Jan 23rd 2003
From The Economist print edition

Every three months, *The Economist* polls a group of forecasters and averages their predictions for economic growth and current-account balances in 25 emerging economies. In general, our panel has become gloomier over the past three months. Average forecasts for GDP growth in 2003 have been reduced in 16 emerging economies. Forecasts for 2003 GDP growth remain unchanged for six countries. Our seers have raised their growth forecasts in only three countries: Argentina, Peru and Turkey. In Argentina, our forecasters now expect GDP to rise by 1.1% this year. Three months ago they expected a mere 0.2% GDP growth in 2003. In Brazil, however, the seers have become gloomier. Their projections for 2003 GDP growth have fallen from 2.2% to 1.7%.

January

	Real GDP % change		Current account % of GDP	
	2002	2003	2002	2003
China	7.9	7.4	1.5	1.2
Hong Kong	1.8	3.0	9.5	9.9
India	4.8	5.7	0.3	0.1
Indonesia	3.4	3.3	3.5	2.9
Malaysia	4.0	4.7	7.3	7.0
Philippines	3.9	3.8	6.4	5.8
Singapore	2.5	3.5	22.2	21.0
South Korea	6.0	5.0	1.4	1.0
Taiwan	3.2	3.4	6.9	6.1
Thailand	4.5	4.2	5.3	4.4
Argentina	−11.5	1.1	7.5	8.5
Brazil	1.4	1.7	−2.6	−1.7
Chile	2.1	3.6	−1.1	−1.4
Colombia	1.6	2.4	−2.4	−2.5
Mexico	1.3	3.2	−2.5	−2.8
Peru	4.5	3.3	−1.8	−1.6
Venezuela	−7.2	−2.1	5.8	5.1
Egypt	2.2	2.6	−0.8	−0.9
Israel	−1.2	1.4	−2.2	−1.9
South Africa	2.9	2.9	0.3	−0.4
Turkey	5.9	4.2	−0.7	−1.5
Czech Republic	2.4	3.1	−4.9	−4.8
Hungary	3.3	3.6	−5.4	−4.9
Poland	1.2	2.7	−3.7	−3.8
Russia	4.1	4.1	8.7	6.2

Sources: ABN Amro; Deutsche Bank; Economist Intelligence Unit; Goldman Sachs; HSBC; ING Financial Markets; J.P.Morgan Chase; Merrill Lynch; Salomon Smith Barney; UBS Warburg.

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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.2	Q4	+14.9	Dec	– 0.4	Dec	+30.4	Dec	+17.4	2001	269.9	Oct
Hong Kong	+ 3.3	Q3	– 7.2	Q3	– 1.5	Dec	– 7.5	Nov	+16.5	Q3	111.6	Dec
India	+ 5.8	Q3	+ 3.6	Nov	+ 3.6	Nov	– 6.9	Nov	+ 4.5	Q3	67.0	Dec
Indonesia	+ 3.9	Q3	– 7.6	Jul‡	+10.0	Dec	+25.7	Nov	+ 6.9	Q2	29.0	Nov
Malaysia	+ 5.6	Q3	+ 6.4	Nov	+ 1.7	Dec	+13.5	Nov	+ 6.6	Q3	33.3	Nov
Philippines	+ 3.8	Q3	– 5.8	Oct	+ 2.6	Dec	+ 1.8	Nov	+ 6.1	Sep	13.0	Dec
Singapore	+ 2.6	Q4	– 0.7	Nov	+ 0.4	Dec	+ 8.5	Nov	+18.9	Q3	82.3	Dec
South Korea	+ 5.8	Q3	+ 7.1	Nov	+ 3.7	Dec	+11.3	Dec	+ 6.5	Nov	121.3	Dec
Taiwan	+ 4.8	Q3	+10.5	Dec	+ 0.8	Dec	+18.1	Dec	+25.0	Q3	161.7	Dec
Thailand	+ 6.0	Q3	+10.9	Nov	+ 1.6	Dec	+ 4.8	Nov	+ 7.8	Nov	36.9	Nov
Argentina	–10.1	Q3	– 4.6	Nov	+41.0	Dec	+16.3	Nov	+ 7.0	Q3	10.5	Dec
Brazil	+ 2.4	Q3	+ 4.5	Dec	+12.5	Dec	+13.1	Dec	– 9.4	Nov	35.6	Nov
Chile	+ 1.8	Q3	+ 0.2	Nov	+ 2.8	Dec	+ 2.4	Dec	+ 0.9	Q3	15.4	Dec
Colombia	+ 1.9	Q3	+ 5.3	Oct	+ 7.0	Dec	+ 0.1	Oct	– 1.5	Q3	10.6	Dec
Mexico	+ 1.8	Q3	– 0.5	Nov	+ 5.7	Dec	– 8.3	Nov	–16.1	Q3	46.8	Nov
Peru	+ 5.9	Nov	+ 7.4	Nov	+ 1.5	Dec	+ 0.3	Nov	– 1.0	Q3	9.2	Nov
Venezuela	– 5.5	Q3	–10.5	Oct	+31.2	Dec	+11.4	Q3	+ 4.9	Q3	8.8	Oct
Egypt	+ 3.1	2002†	+ 7.8	2001†	+ 2.8	Oct	– 8.0	Sep	+ 0.1	Q3	12.9	Sep
Israel	– 0.8	Q3	+11.8	Oct	+ 6.5	Dec	– 6.8	Dec	– 1.9	Q3	24.0	Dec
South Africa	+ 3.1	Q3	+ 2.5	Nov	+14.5	Nov	+ 3.6	Nov	nil	Q3	6.0	Nov
Turkey	+ 7.9	Q3	+ 8.6	Nov	+29.7	Dec	–12.8	Oct	+ 0.6	Oct	26.0	Nov
Czech Republic	+ 1.5	Q3	+ 4.4	Nov	+ 0.6	Dec	– 2.4	Dec	– 4.2	Q3	23.6	Dec
Hungary	+ 3.4	Q3	+ 6.0	Nov	+ 4.8	Dec	– 3.0	Nov	– 3.3	Nov	9.8	Nov
Poland	+ 1.6	Q3	+ 5.1	Dec	+ 0.8	Dec	–10.2	Nov	– 6.7	Nov	28.7	Dec
Russia	+ 4.3	Q3	+ 3.2	Dec	+15.1	Dec	+44.2	Nov	+30.3	Q3	44.1	Dec
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	– 0.5	Jun	+ 3.3	Dec	– 1.3	Dec	+ 2.7	2002†	7.3	Nov
Saudi Arabia	+ 1.2	2001	na		– 0.9	Oct	+39.2	2001	+ 9.4	2001	21.4	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; UBS Warburg; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Jan 23rd 2003
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	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jan 22nd		Dec 31st 2001	
	Jan 22nd	year ago	Jan 22nd	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.4	na	1,526.0	+0.1	– 10.9	– 10.9
Hong Kong	7.80	7.80	12.6	1.43	9,560.3	– 3.2	– 16.1	– 16.1
India	47.9	48.2	77.3	5.39	3,357.0	nil	+ 2.9	+ 3.6
Indonesia	8,855	10,400	14,288	13.51	405.7	nil	+ 3.5	+ 21.5
Malaysia	3.80	3.80	6.13	3.10	672.4	+0.6	– 3.4	– 3.4
Philippines	53.7	51.7	86.6	6.88	1,052.4	– 2.1	– 9.9	– 13.4
Singapore	1.73	1.84	2.80	0.81	1,369.1	– 1.3	– 15.7	– 10.2
South Korea	1,177	1,331	1,899	4.58	622.5	– 4.0	– 10.3	+ 0.2
Taiwan	34.5	35.0	55.7	1.70	4,993.3	– 0.5	– 10.1	– 8.9
Thailand	42.7	44.2	69.0	1.86	373.2	+0.4	+ 22.8	+ 27.1
Argentina	3.07	1.75	4.95	6.30	568.7	– 3.1	+ 92.5	– 37.3
Brazil	3.50	2.38	5.65	24.90	11,142.5	– 6.9	– 17.9	– 45.9
Chile	730	672	1,178	2.64	4,999.5	– 1.2	– 7.4	– 16.1
Colombia	2,951	2,237	4,761	7.62	1,652.1	– 2.2	+ 54.3	+ 19.1
Mexico	10.80	9.15	17.4	8.54	6,024.1	– 5.9	– 5.5	– 19.7
Peru	3.50	3.46	5.65	3.68	1,536.2	+3.0	+ 30.7	+ 28.5
Venezuela	1,922	763	3,101	30.74	8,015.2§	na	+ 22.0	– 51.9
Egypt	4.63	4.63	7.47	4.60	5,505.0	+2.9	+ 4.4	+ 3.2
Israel	4.89	4.61	7.89	6.03	314.3	– 3.5	– 29.7	– 36.6
South Africa	9.0	11.4	14.5	13.60	9,445.9	– 0.9	– 9.5	+ 20.8
Turkey	1,673,000	1,365,000	2,699,386	42.00	10,544.7	+2.6	– 23.5	– 33.5
Czech Republic	29.7	36.3	47.9	2.69	469.0	– 2.9	+ 18.9	+ 42.2
Hungary	233	275	376	5.74	7,735.5	– 1.4	+ 8.5	+ 28.0
Poland	3.90	4.10	6.29	6.45	14,301.2	– 5.0	+ 2.7	+ 4.2
Russia	31.8	30.6	51.3	21.00	342.9	– 5.0	+ 37.5	+ 31.9
EMF (MSCI)*	1.00	1.00	1.61	na	296.1	– 3.9	na	– 6.7
EMBI+†	1.00	1.00	1.61	na	230.4	– 1.0	na	+ 15.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. § Nov 29th.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; UBS Warburg; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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